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No.

In the Supreme Court of the United States

OCTOBER TERM, 1982

UNITED STATES OF AMERICA, PETITIONER

v.

WHITING POOLS, INC.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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QUESTION PRESENTED

Whether a bankruptcy court in a reorganization proceeding under Chapter 11 of the Bankruptcy Code may compel the government, pursuant to 11 U.S.C. (Supp. IV) 542(a), to turn over property to the debtor-in-possession, where the government had seized the property by levy prior to the filing of the bankruptcy petition to satisfy the debtor's delinquent federal tax liabilities.

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UNITED STATES OF AMERICA, PETITIONER

v.

WHITING POOLS, INC.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

The Solicitor General, on behalf of the United States of America, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Second Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App. A, *infra*, 1a-32a) is reported at 674 F.2d 144. The opinions of the district court (App. C, *infra*, 46a-51a) and the order, memorandum and decision of the bankruptcy court (App. B, *infra*, 33a-45a) are not officially reported.

JURISDICTION

The judgment of the court of appeals was entered on March 9, 1982. By orders dated May 28 and June 28, 1982, Justice Marshall extended the time for filing a petition for a writ of certiorari to and including August 6, 1982. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(a).

STATUTES INVOLVED

Sections 363, 541, and 542 of the Bankruptcy Code (11 U.S.C. (Supp. IV)) and Section 6331 of the Internal Revenue Code of 1954 (26 U.S.C.) are set forth in App. D, *infra*, at 52a-56a.

STATEMENT

Respondent is a corporation which was engaged in the business of installing and servicing swimming pools and selling related supplies. During 1979 and 1980, the government made several assessments against respondent for unpaid withholding and employment taxes that it concededly owed in the amount of approximately $92,000, plus interest. On January 14, 1981, the Internal Revenue Service, acting pursuant to Section 6331 of the Internal Revenue Code of 1954, levied upon property belonging to respondent. The levy was authorized by a warrant issued by a United States Magistrate. After entering respondent's place of business, the Service seized respondent's inventory, equipment, and other tangible property (App. A, *infra*, 1a-2a).

On the day following the Service's levy, respondent filed a petition for reorganization under Chapter 11 of the Bankruptcy Code and was continued as a debtor-in-possession. One month later, on February 18, 1981, the United States commenced an adversary proceeding in the United States Bankruptcy Court for the Western District of New York, seeking a determination that the automatic stay provision of the bankruptcy law (11 U.S.C. (Supp. IV) 362) was inapplicable to its proposed sale of the seized property, or, alternatively, that it be permitted to sell the property it had seized from respondent. The debtor counterclaimed, seeking an order requiring the United States to turn over the seized property to it pursuant to Section 542 of the Bankruptcy Code (App. A, *infra*, 1a-2a).

The bankruptcy court agreed with the government that under the law then applicable in the Western District of New York (see *In re Avery Health Center, Inc.*, 7 Bankr. Ct. Dec.

(CRR) 210 (W.D.N.Y. 1981)) the debtor was not entitled to compel a turnover of the property under Section 542. In so holding, the bankruptcy court agreed with the government that only "property of the estate" — *i.e.*, interests in property belonging to the debtor at the time of the filing of the bankruptcy petition — is required to be turned over to a debtor pursuant to Section 542. Because the debtor had no right to have the property returned at the time the petition was filed, absent payment of the federal taxes, it had no such right in that property that would have been subject to a turnover order under that provision.

The bankruptcy court nevertheless ordered the government to turn over the seized property on the theory that the government was a "custodian" within the meaning of Section 543 of the Bankruptcy Code (11 U.S.C. (Supp. IV)), and thus was required by that Section to deliver to the trustee the "property of the debtor" under its control. However, the bankruptcy court conditioned turnover upon the debtor's payment to the government of $20,000 in order to protect the government's interests in the seized property (App. B, *infra*, 39a-43a).[1]

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[1] The $20,000 which the bankruptcy court ordered paid to the government as a condition of turnover included $15,000 contained in a bank account which the government had also seized by a pre-petition tax levy. Although the estimated worth of the seized property in the hands of respondent as a going concern was $162,876 (App. A, *infra*, 2a), the $20,000 payment was considerably less than the $35,000 that an expert witness estimated the government might be able to obtain upon a sale of the seized property. Accordingly, the government argued in the district court that the "protection" afforded by the bankruptcy court's order was not adequate. Because the district court sustained the government's contention that the debtor was not entitled to a turnover order, it did not reach this issue. The court of appeals, having concluded that turnover was authorized in a tax levy context, remanded the case with instructions to address and redetermine the issue of the adequacy of the protection before any new turnover order is issued.

On appeal, the district court upheld the government's position in all respects. It ruled that the government was not a "custodian" subject to the turnover provisions of Section 543 with respect to property seized by a tax levy executed before a bankruptcy petition is filed. Following its decision in *Avery Health Center*, *supra*, the district court likewise rejected the debtor's contention that the government could be compelled pursuant to Section 542 to turn over the seized property. The district court therefore reversed the order of the bankruptcy court requiring the government to deliver the property to the debtor (App. C, *infra*, 46a-51a).

The court of appeals reversed. Although it agreed with the district court that the government is not a "custodian" of property seized in a tax levy (App. A, *infra*, 7a-10a), it concluded that the government could be ordered to turn over such property under Section 542, provided the debtor could demonstrate that the government's interest in the property would be adequately protected (*id.* at 10a-32a).

In so holding, the court acknowledged that the question was a "close one," and that the only other court of appeals that had considered the question had reached a contrary conclusion. *Cross Electric Co.* v. *United States*, 664 F.2d 1218 (4th Cir. 1981). The court's review of the cases regarding the turnover authority of the bankruptcy courts, with respect to property held by certain private creditors, under Sections 257 and 507 of prior law (Act of June 22, 1938, ch. 575, 52 Stat. 902 and 927, 11 U.S.C. 657 and 907), and of the testimony before congressional committees during the hearings leading to the enactment of the Bankruptcy Code, led it to believe that Congress must have intended to incorporate in the new Bankruptcy Code the rule with respect to turnover authority that had developed in the decisions under the old Bankruptcy Act (App. A, *infra*, 12a-23a). Thus, despite the fact that this turnover authority had never been exercised under the prior law against the government in the context of a tax levy, the court of appeals concluded that the turnover authority under the new Bankruptcy Code extended to property seized by a federal tax levy (*id.* at 23a-31a). The court of appeals therefore remanded the

case to the bankruptcy court to "consider whether a turnover order is appropriate under present circumstances and, if it decides in the affirmative, what protection should be afforded to the United States" (App. A, *infra*, 32a).

REASONS FOR GRANTING THE PETITION

1. The decision of the court of appeals squarely conflicts with *Cross Electric Co.* v. *United States*, 664 F.2d 1218 (4th Cir. 1981). In *Cross Electric*, the Fourth Circuit held that a bankruptcy court had no authority to order the government to turn over to the debtor-in-possession property seized by a tax levy prior to the filing of a bankruptcy petition. The court pointed out that after the government's pre-bankruptcy tax levy, the debtor has only three rights—(1) the right to redeem the property, (2) the right to notice of sale, and (3) the right to any surplus proceeds generated by a tax sale. See Internal Revenue Code of 1954 (26 U.S.C.), Sections 6335(b), 6337(a) and 6342. Those limited rights do not include the right to the use or possession of the seized property, without payment of the taxes due. Since the applicable provision of the Bankruptcy Code (11 U.S.C. (Supp. IV) 541(a)(1)) specifies that only the "interests of the debtor in property as of the commencement of the case" become property of the estate, the Fourth Circuit ruled that property levied upon for taxes prior to bankruptcy is not subject to a turnover order under Section 542 of the Bankruptcy Code (664 F.2d at 1220-1221).

Here, by contrast, the court of appeals concluded that Congress must have intended to incorporate in the new Bankruptcy Code the substantive rule regarding turnover authority that had developed under case law interpreting Sections 257 and 507 of the prior Bankruptcy Act. While the court of appeals did not specifically interpret the new statutory provisions or indicate the scope of the authority it believed Congress intended to enact, it held that property seized by a pre-petition tax levy is subject to the turnover authority contained in the new Bankruptcy Code. The conflict in the circuits on this

important question requires resolution by this Court to establish a uniform national rule governing the relationship of the bankruptcy laws to the government's statutory authority to collect delinquent federal taxes.[2]

2. The decision below is contrary to the plain meaning of the relevant statutory provisions and Congress' intent in enacting the new Bankruptcy Code.

a. Section 542(a) of the Bankruptcy Code (App. D, *infra*, 54a) provides that property which the trustee may "use, sell, or lease," but which is out of the immediate possession of the

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[2] The lower courts are also divided on this issue. The decisions holding that turnover of property seized by a tax levy is not authorized include: *In re Avery Health Center, Inc.*, 7 Bankr. Ct. Dec. (CRR) 210 (Bankr. W.D.N.Y. 1981); *Parker GMC Truck Sales, Inc.* v. *United States*, 6 Bankr. Ct. Dec. (CRR) 899 (Bankr. S.D. Ind. 1980); *Winfrey Structural Concrete Co.* v. *IRS*, 6 Bankr. Ct. Dec. (CRR) 695 (Bankr. D. Colo. 1980); *Bush Gardens, Inc.* v. *United States*, 5 Bankr. Ct. Dec. (CRR) 1023 (D.N.J. 1979); *In re Paukner*, 10 Bankr. 29 (Bankr. N.D. Ohio 1981); *Douglas* v. *United States*, 7 Bankr. Ct. Dec. (CRR) 690 (Bankr. D. Neb. 1981); *In re Bishop & Son, Inc.*, 81-2 U.S. Tax Cas. (CCH) ¶ 9555 (Bankr. W.D. Mo. 1981); *In re Cyber Electric Co.*, 49 A.F.T.R.2d (P-H) ¶ 82-520 (Bankr. E.D. Mich. 1982). The contrary decisions upholding turnover authority against the government include: *In re Aurora Cord & Cable Co.*, 2 Bankr. 342 (Bankr. N.D. Ill. 1980), aff'd, No. 80-C-396 (N.D. Ill. Dec. 1, 1981) (unpublished opinion); *Alpa Corp.* v. *IRS*, 7 Bankr. Ct. Dec. (CRR) 791 (Bankr. D. Utah 1981), appeal pending, No. C81-0490J (D. Utah, filed July 2, 1981); *Bristol Convalescent Home, Inc.* v. *IRS*, 7 Bankr. Ct. Dec. (CRR) 1151 (Bankr. D. Conn. 1981) (debtor, however, declined to afford adequate protection and thus turnover was never in fact ordered).

Two cases involving state, rather than federal, tax levies also hold that the seized property must be turned over for the debtor's use. *Troy Industrial Catering Service* v. *State of Michigan*, 2 Bankr. 521 (Bankr. E.D. Mich. 1980); *Barsky* v. *Commonwealth of Pennsylvania*, 6 Bankr. Ct. Dec. (CRR) 1216 (Bankr. E.D. Pa. 1981).

debtor, must be turned over to the trustee appointed to oversee the estate.[3] The provision states that—

> an entity * * * in possession, custody, or control, during the case, of property that the trustee may use, sell, or lease under section 363 of this title * * * shall deliver to the trustee, and account for, such property or the value of such property, unless such property is of inconsequential value or benefit to the estate.

Section 363 states that the trustee may "use, sell, or lease" the "property of the estate."[4] Thus, Section 542 authorizes the turnover of "property of the estate."

In turn, for present purposes,[5] Section 541(a)(1) of the Bankruptcy Code defines "property of the estate" to include "all legal or equitable interests of the debtor in property *as of the*

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[3] In certain cases arising under Chapter 11 of the Bankruptcy Code, such as the instant case, the debtor remains in possession of the assets of the estate; the "debtor-in-possession" in such cases has all of the rights, powers and duties of a trustee. See 11 U.S.C. (Supp. IV) 1107(a).

[4] Section 363(b) of the Bankruptcy Code provides, in pertinent part, that "[t]he trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, *property of the estate*" (emphasis supplied). Similarly, Section 363(c)(1) provides, with exceptions not relevant here, that where the business of the debtor is authorized to be operated, the trustee may use "property of the estate" without notice or a hearing in the ordinary course of business.

[5] Other subsections of Section 541(a) (see Sections 541(a)(2) through (7)) specify that "property of the estate" includes additional property interests in which the debtor had no right as of the commencement of the case. For example, property of the estate includes property that a custodian must turn over pursuant to Section 543, property that the trustee recovers by using his avoiding powers (see Sections 544, 545, 547, 548 and 550), and other specified interests. See, *e.g.*, 11 U.S.C. 541(a)(3). The court of appeals did not rely upon any of these provisions.

commencement of the case" (emphasis supplied). Thus, the estate includes only the debtor's interests in property as of the date on which a petition is filed under the Bankruptcy Code. The debtor's interest in such property becomes "property of the estate" without regard to whether the debtor has title to the property or has possession of it. H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 367-368 (1977); S. Rep. No. 95-989, 95th Cong., 2d Sess. 82-83 (1978).

Although the scope of Section 541(a)(1) is broad, it is not unlimited. The legislative history makes it clear that the provision was not intended to enlarge the debtor's rights in property.[6] Thus, the House and Senate Reports state that (H.R. Rep. No. 95-595, *supra*, at 367-368; S. Rep. No. 95-989, *supra*, at 82 (emphasis supplied))—

> [T]his paragraph [Section 541(a)(1)] * * * *is not intended to expand the debtor's rights against others more than they exist at the commencement of the case.* For example, if the debtor has a claim that is barred at the time of the commencement of the case by the statute of limitations,

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[6] Section 541 is somewhat broader than the predecessor provision (Section 70a of the Bankruptcy Act (Act of July 1, 1898, ch. 541, 30 Stat. 565, 11 U.S.C. 110(a)). Under the new provision, the debtor need not prove possession or constructive possession of the property in order to obtain its interests in the property for the benefit of the estate. That broader scope does not, however, expand the debtor's property interests.

After the case is commenced, in some circumstances the trustee may have different rights than the debtor would have had. For example, the trustee has an additional time period in which to pursue a claim, where the statute of limitations had not expired prior to filing the petition for relief under the Bankruptcy Code. See 11 U.S.C. (Supp. IV) 108; see also H.R. Rep. No. 95-595, *supra*, at 367; S. Rep. No. 95-989, *supra*, at 82. Such exceptions to the general rule that the estate acquires whatever rights the debtor had are explicitly set forth in the Bankruptcy Code.

> then the trustee would not be able to pursue that claim, because he too would be barred. He could take *no greater rights than the debtor himself had.* * * *

The remarks of the principal congressional sponsors just prior to enactment are to the same effect. While acknowledging that Section 541(a) is an "all-embracing definition" which includes all "beneficial rights and interests" that the debtor may have, they nevertheless pointed out that (124 Cong. Rec. 32399, 33999 (1978) (emphasis added))—

> * * * *only the debtor's interest* in such property *becomes property of the estate.* If the debtor holds bare legal title or holds property in trust for another, only those rights which the debtor would have otherwise had emanating from such interest pass to the estate under Section 541.[7]

Thus, by virtue of Section 541(a)(1) the estate acquires only the debtor's interests in property. If the debtor's interests in property are limited, then the estate acquires only those limited

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[7] The legislative history contains numerous similar descriptions of Congress' intent. For example, Section 541(d) "reiterates the general principle that where the debtor holds bare legal title without any equitable interest, the estate acquires bare legal title without any equitable interest in the property." 124 Cong. Rec. 32399 (1978). The converse is also true (*ibid.*; emphasis added):

> Similarly, if the debtor holds an equitable interest in property without legal title, the estate would acquire only the equitable interest of the debtor in property and not the legal title. Thus, as section 541(a)(1) clearly states, the estate is comprised of all legal or equitable interest of the debtor in property as of the commencement of the case. *To the extent such an interest is limited in the hands of the debtor, it is equally limited in the hands of the estate* except to the extent that such defenses which are personal against the debtor are not effective against the estate.

See also, 4 *Collier on Bankruptcy* ¶ 541.24, at 541-88 (15th ed. 1979). Indeed, Congress' belief that this principle was clearly established resulted in its deletion of two provisions upon which it was based. The Senate had proposed that Section 541 expressly provide that property of the estate does not include amounts held by the debtor as

interests. 4 *Collier on Bankruptcy* ¶ 541.01, at 541-5 to 541-7 (15th ed. 1979). Accordingly, under the plain terms of the relevant statutory provision and the accompanying explanation set forth in the House and Senate reports, the "property of the estate" that a court may require to be turned over to the debtor-in-possession by virtue of Section 542(a) is its interests in property as of the date it filed its petition for relief pursuant to the Bankruptcy Code.

b. The Bankruptcy Code does not itself define the property interests of a debtor. That is a matter determined by reference to non-bankruptcy law. 4 *Collier*, *supra*, ¶ 541.02(1), at 541-10. Here, since the Internal Revenue Service seized the property sought by the debtor pursuant to a levy authorized by Section 6331 of the Internal Revenue Code to satisfy the debtor's federal tax liabilities, the interest of the debtor in the property must be determined by reference to the Internal Revenue Code.

The relevant provisions of the Internal Revenue Code make it clear that subsequent to a levy, the debtor's rights in the seized property are exceedingly limited. The debtor retains only the rights to "redeem" the property by paying the amount of tax due (Section 6337(a)), to receive notice of sale of the property (Section 6335(b)), and to obtain any surplus in the proceeds realized at sale (Section 6342). Since the debtor does not have the right prior to filing for reorganization to return of property seized for payment of taxes, unless he pays his arrearages in full, the debtor's estate does not obtain that right at the time of filing for reorganization. Accordingly, the debtor is not entitled pursuant to Section 542 to compel the turnover of property seized to satisfy the delinquent taxes. See *Cross Electric Co.* v. *United States*, *supra*, 664 F.2d at 1220-1221; *In*

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trustee or any taxes withheld or collected from others before the commencement of the case. These provisions were omitted as unnecessary since only the "legal and equitable interests of the debtor" become property of the estate. 124 Cong. Rec. 32147, 34016-34017 (1978).

re Avery Health Center, Inc., *supra*, 7 Bankr. Ct. Dec. at 212; *Parker GMC Truck Sales, Inc.* v. *United States*, 6 Bankr. Ct. Dec. (CRR) 899, 900 (Bankr. S.D. Ind. 1980).

c. Although the court of appeals found "some force" (App. A, *infra*, 12a) in the foregoing construction of the statutes, it concluded that it "ultimately must reject it" (*ibid.*). The court began its analysis by noting that in certain reorganization cases arising under prior law—specifically, under either Chapter X or XII of the Bankruptcy Act—a bankruptcy court had the authority to order secured creditors who had lawfully repossessed property of the debtor, but had not yet disposed of that property, to turn such property over the the reorganizing debtor. See Sections 257 and 507 of the Bankruptcy Act; *Reconstruction Finance Corporation* v. *Kaplan*, 185 F.2d 791 (1st Cir. 1950). The court of appeals observed that no specific provisions comparable to Sections 257 and 507 were enacted as part of the new Bankruptcy Code, and reasoned that if the Government's interpretation of Sections 363, 541, and 542 of the Code were adopted, the turnover power available in Chapters X and XII of prior law would not be available under the new Code. The court believed that Congress could not have intended such a result (App. A, *infra*, 12a-17a).

In reaching its conclusion that Congress intended to incorporate in the new Bankruptcy Code prior law with respect to turnover, the court relied upon the statements of certain witnesses before the congressional committees, urging that the turnover authority be made explicit in the new Bankruptcy Code. Noting that Congress added Section 542(a) to the proposed bill subsequent to this testimony, the court concluded that this sequence of events supported the inference that Congress intended Section 542(a) of the new Bankruptcy Code to codify the result under Sections 257 and 507 of the Bankruptcy Act (App. A, *infra*, 17a-23a).[8]

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[8] Sections 257 (in a Chapter X case) and 507 (Chapter XII) of the Bankruptcy Act specifically provided trustees with the right to "immediate possession of all property of the debtor in the possession of a

Finally, the court reasoned that because Section 542 was intended to authorize turnovers of repossessed collateral from secured creditors, such turnover authority should likewise exist with respect to property seized by a pre-petition tax levy. The court noted (App. A, *infra*, 25a) that the restrictions under prior bankruptcy law on the bankruptcy court's "summary" jurisdiction, which were in part the basis of the Court's decision in *Phelps* v. *United States*, 421 U.S. 330 (1975), no longer constituted an impediment to turnover authority under the new Code. The court of appeals believed that the government's position after a tax levy was indistinguishable from that of a creditor who has repossessed the debtor's property. Finding that the debtor in a tax levy situation is not divested of all "ownership" rights in the seized property, the court concluded that the debtor was as entitled to turnover of property seized to satisfy delinquent taxes as it was with respect to collateral in the possession of a secured creditor (App. A, *infra*, 26a-28a).

3. We submit the decision below is flatly at odds with the plain language of the relevant provisions of the Bankruptcy Code and the explanation of those provisions in the House and Senate reports. The court of appeals simply dismissed the government's reading of the plain terms of the statute as "mechanical" (App. A, *infra*, 12a), and instead supplied the result it believed Congress must have intended. But a court's first duty in interpreting a statute is to look to the terms employed in a statutory provision where the terms are plain and that method produces a reasonable result. See, *e.g.*, *Commissioner* v. *Brown*, 380 U.S. 563, 571 (1965); *Consumer Product Safety Commission* v. *GTE Sylvania, Inc.*, 447 U.S. 102,

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trustee under a trust deed or a mortgagee under a mortgage." A line of cases including *Reconstruction Finance Corporation* (see App. A, *infra*, 15a) extended this turnover authority in Chapters X and XII proceedings to certain other types of "property of the debtor" thought to be analogous to the property interests described in the statutory provisions.

108 (1980); *Middlesex County Sewerage Authority* v. *National Sea Clammers Association*, 453 U.S. 1, 13 (1981); *Rubin* v. *United States*, 449 U.S. 424, 430 (1981); *Howe* v. *Smith*, 452 U.S. 473, 480, 483 (1981); *United States* v. *Turkette*, 452 U.S. 576, 580 (1981). Moreover, when resort to legislative history is necessary to determine the meaning of an ambiguous statutory provision, it is well established that the text of the final House and Senate committee reports explaining the measure, as well as the explanatory remarks concerning the legislation made by the chief sponsors thereof just prior to final passage, are of primary value. *United States* v. *Automobile Workers*, 352 U.S. 567, 585 (1957); *NLRB* v. *Fruit Warehousemen*, 377 U.S. 58, 66 (1964).

The court of appeals gave no weight to the explanations in those primary legislative sources. Rather, the court rested its conclusion largely upon its belief that Congress intended to retain prior law regarding turnover, despite Congress' failure to employ terms accomplishing that end or to make its desire to do so explicit in the House and Senate committee reports. Finally, the court relied upon the statements and proposals of witnesses in hearings before congressional committees, even though the proposals and suggested terms were not employed in the statute that Congress ultimately enacted.[9]

Finally, the court's statutory interpretation cannot be reconciled with the explanation set forth in the reports of the House and Senate committees responsible for reporting out

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[9] For example, the court cited certain testimony, as well as a proposal submitted by the National Bankruptcy Conference, which requested Congress to add a section to the proposed new Code explicitly succeeding Sections 257 and 507 of the Bankruptcy Act (App. A, *infra*, 19a-21a). Congress declined, however, to enact the cited proposal. Under the National Bankruptcy Conference proposal, "custodians" and "creditors in possession" would have been required to turn over "property of the debtor" in their possession. See App. A, *infra*, 21a n.16. The terms of the proposal are similar to the terms eventually enacted in Section 543, governing turnover of property by custodians. And the court of appeals held that the Internal

the legislation (see pages 8-9, *supra*). For example, the court of appeals stated (App. A, *infra*, 29a) that its ruling is "entirely consistent" with Congress' intent that Section 541(a)(1) would not expand the trustee's rights beyond those of the debtor at the commencement of the case.

But that is simply not the case. As we have pointed out (page 10, *supra*), at the time the debtor filed its petition, it did not have any right to obtain the seized property, absent full payment of its tax liability. The court, however, expanded the rights of the debtor in reorganization beyond those it had prior to the filing of its petition—a result plainly inconsistent with the explanations of the House and Senate committee reports.

4. The court of appeals therefore erred in concluding that Congress intended to incorporate in Section 542 of the new Bankruptcy Code a "rule" unexpressed by Congress that had developed (the court assumed) under case law interpreting Section 257 of the Bankruptcy Act.[10] But even on the assumption that the court's conclusion in this respect was sound, the court nevertheless erred in extending such turnover authority to reach property seized by a pre-petition tax levy.

The essence of the court's theory is that the turnover authority in Chapters X and XII proceedings under the Bankruptcy Act was such a crucial tool of reorganizing debtors that Congress could not be thought to have omitted that authority under the new Code, without some affirmative indication that

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Revenue Service is not a "custodian" of property seized in a levy within the meaning of Section 543(a) (App. A, *infra*, 10a). But insofar as entities other than custodians are concerned, Congress enacted a very different provision. Section 542(a), through its reference to Section 363, provides for turnover only of "property of the estate."

[10] The court of appeals acknowleged (App. A, *infra*, 15a), however, the scope of that turnover authority was regarded as unsettled under prior bankruptcy law. See, *e.g.*, Murphy, *Restraint and Reimbursement: The Secured Creditor in Reorganization and Arrangement Proceedings*, 30 Bus. Law. 15, 39 (1974).

it was doing so. That reasoning, however, provides no justification for establishing a substantive rule of law requiring the turnover of property seized prior to bankruptcy to satisfy the debtor's delinquent tax liabilities. Under prior law, property seized by a pre-petition tax levy was not subject to turnover authority either in liquidating bankruptcies (*Phelps* v. *United States, supra)* or in reorganization proceedings (*In re Pittsburgh Penguins Partners*, 598 F.2d 1299 (3d Cir. 1979)).[11]

Thus, while the court of appeals expressed the view (App. A, *infra*, 16a) that it should avoid declaring a major change in the law without some unambiguous indication that Congress so intended, that is precisely the course it followed in this case. In holding that the Internal Revenue Service is subject to turnover orders for property seized pursuant to levy prior to bankruptcy, the court has in fact made a drastic change in the law concerning collection of taxes, without any explicit indication in the legislative history that Congress in fact intended so substantially to alter the long-accepted status of government tax levies. Significantly, the Senate Finance Committee Report, which summarized the tax aspects of the proposed legislation, did not mention any intended change from prior law with respect to turnover authority in the context of a tax levy. S. Rep. No. 95-1106, 95th Cong., 2d Sess. (1978). As this Court has stated, "[i]t will not be inferred that the legislature, in revising and consolidating the laws, intended to change their policy, unless such intention be clearly expressed." *United States* v. *Ryder*, 110 U.S. 729, 740 (1884). Accord: *Aberdeen & R.R.R.* v. *Students Challenging Regulatory Agency Procedures*, 422 U.S. 289, 309 n.12 (1975); *Muniz* v. *Hoffman*, 422 U.S. 454, 467-472 (1975); *Fourco Glass Co.* v. *Transmirra Products Corporation*, 353 U.S. 222, 227 (1957).

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[11] Although *Pittsburgh Penguins* arose under Chapter XI of the Bankruptcy Act, no case holds that such turnover activity existed in a tax levy context under either of the other two reorganization chapters, Chapters X and XII.

In sum, whether or not Congress by implication incorporated previously existing turnover authority in the new Bankruptcy Code, the decision below erred in extending such authority to destroy the efficacy of federal tax levies.[12] Such a fundamental change in the bankruptcy law as it affects the government's authority to collect delinquent taxes calls for review by this Court.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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AUGUST 1982

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[12] The legislative history indicates that "trust fund" taxes are not "property of the estate," even where the collected taxes are in the possession of the debtor when the petition is filed. 124 Cong. Rec. 32147, 34016-34017 (1978). Hence, the withheld taxes still in the debtor's possession would not be property available for the debtor's use. Ironically, however, under the court of appeals' decision, when the government has taken active steps to collect by levy delinquent amounts due for such withholding taxes, the court would require that the seized property be returned to the debtor for its use.

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 441—August Term, 1981
(Argued: December 3, 1981 Decided: March 9, 1982)
Docket No. 81-5046

UNITED STATES OF, AMERICA,
Plaintiff-Appellee,

—against—

WHITING POOLS, INC.,
Defendant-Appellant.

Before

FRIENDLY, OAKES AND PIERCE,
Circuit Judges.

FRIENDLY, *Circuit Judge:*

The question on this appeal is whether a debtor in possession under Chapter 11 of the Bankruptcy Code of 1978 is entitled to an order, under §§ 542 or 543 of the Code, requiring the Internal Revenue Service (IRS) to turn over tangible assets of the debtor on which the IRS had levied pursuant to § 6331 *et seq.* of the Internal Revenue Code (IRC). This question has created much conflict among bankruptcy judges and district courts throughout the nation. [1] The only other court of appeals

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[1] Decisions of bankruptcy and district courts denying the turnover power include; *In re Avery Health Center, Inc.*, 8 B.R. 1016 (W.D.N.Y. 1981); *In re Paukner*, 10 B.R. 29 (Bankr. Ct. N.D. Ohio 1981); *In re Douglas*, 10 B.R. 283 (Bankr. Ct. Neb. 1981); *In re Bishop & Son, Inc.*, 81-2 U.S.T.C. ¶ 9555 (Bankr. Ct. W.D. Mo. 1981); *In re Birco Mining Co.*, 10 B.R. 545 (Bankr. Ct. N.D. Ala.

that has considered the issue has answered it in the negative, *Cross Electric, Inc.* v. *United States*, No. 81-1111, slip op. (4 Cir. November 24, 1981). The issue is of importance to the successful reorganization of debtors, on the one hand, and to the interest of the United States in the quick collection of tax revenues, on the other. We find the issue more difficult than did the Court of Appeals for the Fourth Circuit and, conceding the question to be a close one, reach an opposite result.

Whiting Pools, Inc. (Whiting), the debtor, was in the business of selling, installing and servicing swimming pool equipment and supplies. On January 14, 1981, the IRS, acting pursuant to IRC § 6331, seized all of Whiting's tangible property, including equipment, vehicles, inventory, office equipment and supplies, at its place of business in the Western District of New York. The estimated worth of the seized property in the hands of Whiting as a going concern was $162,876. The lien of the IRS was for some $92,000, plus interest, in unpaid withholding and Federal Insurance Contributions Act taxes. Testimony taken before the bankruptcy judge indicated that sale of the property by the IRS would net a maximum of $30,000 to $35,000, with a more probable recover in the neighborhood of $20,000.

On the day following the IRS levy Whiting filed a petition under Chapter 11 of the Bankruptcy Code and was continued

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1981); *Parker GMC Truck Sales, Inc.* v. *United States*, 6 B.C.D. 899 (Bankr. Ct. S.D. Ind. 1980); *In re Winfrey Structural Concrete Co.* v. *I.R.S.*, 6 B.C.D. 695 (Bankr. Ct. D. Col. 1980); and *Bush Gardens, Inc.* v. *United States*, 10 B.R. 506 (Bankr. Ct. D.N.J. 1979).

Decisions of bankruptcy and district courts upholding the power include: *In re Alpa Corp.*, 11 B.R. 281 (Bankr. Ct. D. Utah 1981), *appeal pending*. (D. Utah); *In re Bristol Convalescent Home, Inc.*, 7 B.C.D. 1151 (Bankr. Ct. D. Conn. 1981); *In re Aurora Cord & Cable Co.*, 2 B.R. 342 (Bankr. Ct. N.D. Ill. 1980), *appeal pending*, (N.D. Ill.); *Troy Indus. Catering Service* v. *Michigan*, 2 B.R. 521 (Bankr. Ct. E.D. Mich. 1980) (state tax levy); *In re Barsky*, 6 B.C.D. 1216 (Bankr. Ct. E.D. Pa. 1980).

as a debtor in possession, § 1101(1). A month later the United States initiated an adversary proceeding under § 362(d) of the Code in which it sought a determination that the automatic stay provisions of § 362 were inapplicable to it or, in the alternative, for relief from the stay to permit it to sell the property. It alleged that storing the property was costing $2,500 per month. Whiting's answer contained a counterclaim asking that the IRS be required to turn over the property pursuant to § 542 of the Bankruptcy Code.

Bankruptcy Judge Hayes, after holding hearings, delivered an opinion, 10 B.R. 755 (Bankr. Ct. W.D.N.Y. 1981), in which he concluded that the automatic stay provided in § 362 was applicable to the IRS—a conclusion which is not disputed here. Examining § 362(d), which directs the bankruptcy court to grant relief from such a stay under certain circumstances, [2] the judge found that such relief could be be granted under § 362(d)(2) since the debtor had an equity in the property and the property was "absolutely necessary to an effective reorganization of the debtor." *Id.* at 757. Turning back to § 362(d)(1), the judge concluded that while the best interests of the United States would be served by a reorganization, for which he thought there was a reasonable chance, and the Government could be adequately protected while the reorganization proceeding was pending, it made "little sense to continue the stay unless a turnover of property", *id.*, could

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[2] These are:

§ 362(d) On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay—

(1) for cause, including the lack of adequate protection of an interest in property of such party in interest; or

(2) with respect to a stay of an act against property, if—

(A) the debtor does not have an equity in such property and

(B) such property is not necessary to an effective reorganization.

lawfully be directed. He thus reached what both parties concede to be the crucial issue, namely, whether it could be.

We set forth in the margin the sections of the Bankruptcy Code which must be construed in deciding that question. [3]

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§ 361. Adequate protection—

When adequate protection is required under section 362, 363, or 364 of this title of an interest of an entitity in property, such adequate protection may be provided by—

(1) requiring the trustee to make periodic cash payments to such entity, to the extent that the stay under section 362 of this title, use, sale, or lease under section 363 of this title, or any grant of a lien under section 364 of this title results in a decrease in the value of such entity's interest in such property;

(2) providing to such entity an additional or replacement lien to the extent that such stay, use, sale, lease, or grant results in a decrease in the value of such entity's interest in such property; or

(3) granting such other relief, other than entitling such entity to compensation allowance under section 503(b)(1) of this title as an administrative expenses, as will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property. § 363(b) The trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate.

(c)(1) If the business of the debtor is authorized to be operated under section 721, 1108, or 1304 of this title and unless the court orders otherwise, the trustee may enter into transactions, including the sale or lease of property of the estate, in the ordinary course of business, without notice or a hearing, and may use property of the estate in the ordinary course of business without notice or a hearing.

(2) The trustee may not use, sell, or lease cash collateral under paragraph (1) of this subsection unless—

(A) each entity that has an interest in such cash collateral consents: or

(B) the court, after notice and a hearing, authorizes such use, sale, or lease in accordance with the provisions of this section.

Although Whiting had sought a turnover under § 542, the bankruptcy judge was precluded from granting relief under that section by the decision of District Judge Elfvin in the Western District of New York in *In re Avery Health Center*,

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(3) Any hearing under paragraph (2)(B) of this subsection may be a preliminary hearing or may be consolidated with a hearing under subsection (e) of this section, but shall be scheduled in accordance with the needs of the debtor. If the hearing under paragraph (2)(B) of this subsection is a preliminary hearing, the court may authorize such use, sale, or lease only if there is a reasonable likelihood that the trustee will prevail at the final hearing under subsection (e) of this section. The court shall act promptly on any request for authorization under paragraph (2)(B) of this subsection.

(4) Except as provided in paragraph (2) of this subsection, the trustee shall segregate and account for any case collateral in the trustee's possession, custody, or control.

* * *

(e) Notwithstanding any other provision of this section, at any time, on request of an entity that has an interest in property used, sold, or leased, or proposed to be used, sold, or leased, by the trustee, the court shall prohibit or condition such use, sale, or lease as is necessary to provide adequate protection of such interest. In any hearing under this section, the trustee has the burden of proof on the issue of adequate protection.

§ 541. Property of the estate

(a) The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised of all the following property, wherever located:

(1) Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of this case.

§ 542(a) Except as provided in subsection (c) or (d) of this section, and entity, other than a custodian, in possession, custody, or control, during the case, of property that the trustee may use, sell, or lease under section 363 of this title, or that the debtor may exempt under section 522 of this title, shall deliver to the trustee, and account for

Inc., 8 B.R. 1016 (W.D.N.Y. 1981), with which he seemingly disagreed. Believing that the turnover power formerly provided in proceedings under Chapter X of the Bankruptcy Act by the last sentence of § 257, [4] see *Reconstruction Finance Corp.* v. *Kaplan*, 185 F.2d 791, 795 (1 Cir. 1950), must have gone somewhere, he found them in § 543(b), reading the defini-

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such property or the value of such property, unless such property is of inconsequential value or benefit to the estate.

§ 543(b) A custodian shall—

(1) deliver to the trustee any property of the debtor transferred to such custodian, or proceeds of such property, that is in such custodian's possession, custody, or control on the date that such custodian acquires knowledge of the commencement of this case: and

(2) file an accounting of any property of the debtor, or proceeds of such property, that, at any time, came into the possession, custody, or control of such custodian.

§ 101(10) "custodian" means—

(A) receiver or trustee of any of the property of the debtor, apppointed in a case or proceeding not under this title:

(B) assignee under a general assignment for the benefit of the debtor's creditors: or

(C) trustee, receiver, or agent under applicable law, or under a contract, that is appointed or authorized to take charge of property of the debtor for the purpose of enforcing a lien against such property, or for the purpose of general administration of such property for the benefit of the debtor's creditors.

[4] Section 257 provided:

The trustee appointed under this chapter, upon his qualification, or if a debtor is continued in possession, the debtor, shall become vested with the rights, if any, of such prior receiver or trustee in such property and with the right to the immediate possession thereof. The trustee or debtor in possession shall also have the right to immediate possession of all property of the debtor in the possession of a trustee under a trust deed or a mortgagee under a mortgage.

tion of "custodian" in § 101(10), more particularly the reference to an "agent", as including the IRS, 10 B.R. at 759. After noting the anomaly that §543 seems to permit a turnover without providing for the protection that would be required by reading §§ 363(e) and 542 together, he directed the turnover on the conditions set forth in the margin. [5]

The district court reversed. It adhered to its previous decision in *In re Avery Health Center, Inc., supra*, concerning § 542, and rejected the bankruptcy judge's theory that the IRS was an "agent" under § 101(10)(C) and thus a "custodian" under § 543. It considered that "the concept of agency entails a fiduciary relationship arising out of an express or implied contract between the principal and the agent," and that the IRS, when making a levy under IRC § 6331, did not fill such a role. The court remanded the case to the bankruptcy court to determine whether the stay of the IRS's proposed sale should be lifted. Whiting appealed to this court, and the bankruptcy court declined to take action upon the remand pending our decision.

I. *Section 543*

The definition of "custodian" in § 101(10) finds an antecedent in § 2a(21) of the former Bankruptcy Act, which required, under certain circumstances, delivery of property by "receivers or trustees appointed in proceedings not under this Act,

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[5] (1) That the debtor-in-possession pay IRS as adequate protection under 11 U.S.C. § 361 the sum of $20,000 before the turnover occurs, and

(2) That the debtor shall pay to IRS the sum of $1,000 a month until the tax is paid, and

(3) That during this period of time IRS shall retain its lien upon the property seized, and

(4) That if the debtor fails to make the payments required when IRS turns over the property, the stay shall be lifted. . . ."

assignees for the benefit of creditors, and agents authorized to take possession of or to liquidate a person's property." The definition of custodian in § 101(10) appears in H.R. 8200, 95th Cong., 1st Sess., as reported by the House Committee on the Judiciary on September 8, 1977, H.R. Rep. No. 95-595, with a comment which we reproduce in the margin. [6] The same definition and comment can be found in S. 2266, 95th Cong. 2d Sess. and in S. Rep. No. 95-989 p. 23. These shed little light on the meaning of the phrase "or agent under applicable law, or under a contract" etc.

Since § 101(10)(A) and (B) include two of the categories described in § 2a(21) of the previous Act, § 101(10)(C) must have been intended to include and possibly broaden what had been covered by § 2a(21)'s phrase, "agents authorized to take possession of or to liquidate a person's property". Seemingly it embraces the case of an agent appointed or authorized by a debtor to take charge of property for the purpose of enforcing a lien of a particular creditor, but see, *contra*, *In re Lewis*. 12 B.R. 106, 108-09 (Bankr. Ct. M.D. Ga. 1981), which may not have been true under § 2a(21) of the previous Act. *Compare* 1 Collier on Bankruptcy ¶ 2.78, at 390.23 n.35 (14th ed.) *with In re Rosenberg*, 128 F.2d 924 (7 Cir. 1942).

Here there is no doubt that the IRS is "authorized to take charge of property of the debtor for the purpose of enforcing a lien against . . . property" of the debtor. However, the definition of "custodian" does not include anyone who is so authorized but only a person who acts as a trustee, receiver, or

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[6] Paragraph (10) defines "custodian." There is no similar definition in current law. It is defined to facilitate drafting, and means prepetition liquidator of the debtor's property, such as an assignee for the benefit of creditors, a receiver of the debtor's property, or a liquidator or administrator of the debtor's property. The definition of custodian to include a receiver or trustee is descriptive, and not meant to be limited to court officers with those titles. The definition is intended to include other officers of the court if their functions are substantially similar to those of a receiver or trustee.

agent. Admittedly the IRS is not a trustee or receiver. No one would characterize it as the taxpayer's agent as a matter of ordinary English speech. The Restatement of Agency 2d, § 1 (1958) defines agency as "the fiduciary relation which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control, and consent by the other so to act." See also Restatement of Agency 2d § 1, Comment, at pp. 8-9 (1958). Seizure of property by the IRS under IRC § 6331 is not pursuant to a consensual relationship but is imposed by law irrespective of and generally contrary to the taxpayer's desires. It is true that a person may be an agent under § 101(10)(C) when the relationship is created by law rather than by contract, but it would be a strained reading to interpret this as including the IRS, the archetypical "adverse claimant", see *Phelps* v. *United States*, 421 U.S. 330, 334 (1975). [7] It is thus immaterial that the IRS has certain

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[7] The bankruptcy judge and Whiting seek to draw support for the conclusion that the IRS is a "custodian" under § 543 [illegible] in cases arising under Chapter X of the Bankruptcy Act, most notably *RFC* v. *Kaplan*, 185 F.2d 791 (1 Cir. 1950) (Magruder, C.J.), which held that a creditor who had taken possession of a debtor's goods after default could be required to turn over the goods to a trustee or a debtor in possession. Apart from the fact that the origin of the creditor's possession lay in a consensual transaction, these cases, as is developed below, went not on the ground that the creditor was acting as the debtor's agent but on the basis that § 111 of the Bankruptcy Act gave the reorganization court "exclusive jurisdiction of the debtor and its property wherever located", differing in this respect from ordinary bankruptcy in which the bankruptcy court had jurisdiction only over property in the bankrupt's possession and the trustee was obliged to institute a plenary suit to recover other property. See *In re Prudence-Bonds Corp.*, 77 F.2d 328 (2 Cir.), *cert. denied*, 296 U.S. 584 (1935).

Several bankruptcy courts have held that an ordinary secured creditor in possession is a "custodian" under the Code, and therefore subject to § 543's turnover requirement, *Smitty's Inc.* v. *Southeast National Bank*, 1 C.B.C. 2d 366 (Bankr. Ct. M.D. Fla. 1979) (writ of

responsibilities, such as giving notice of seizure and sale and accounting for any surplus.

Beyond this, in determining the meaning of "custodian" as used in § 543, it is necessary to consider the other provisions of the Code. One of these is § 543(c), which requires the bankruptcy court to provide a custodian with "reasonable compensation for services rendered and costs and expenses incurred." We can think of no reason why Congress would have chosen to provide the IRS with reasonable compensation, as distinguished from reimbursement of expenses, see IRC § 6342(a)(1), for its efforts to dismember the debtor's estate in its own interest. Moreover, as Bankruptcy Judge Hayes noted below, 10 B.R. at 760, § 542's explicit reference to § 363, and thereby to the adequate protection requirements of § 361, suggests that § 542 is a "more appropriate section", 10 B.R. at 760, than § 543 for resolving turnover disputes involving secured creditors.

We therefore conclude that the district judge correctly decided that § 543 afforded no basis for a turnover order, and must consider whether he was also correct in his earlier ruling in *In re Avery Health Center, Inc., supra*, 8 B.R. 1016, to which he adhered in this case, that no basis was furnished by § 542.

II. *Section 542—Turnover Generally*

Determination whether § 542 is here applicable requires consideration of several sections of the Code. Section 542 requires the turnover "of property that the trustee may use, sell

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replevin); *In re Gunder*, 8 B.R. 390, 394 (Bankr. Ct. S.D. Ohio 1980) (repossession); *In re Brickel*, 11 B.R. 353, 355 (Bankr. Ct. D. Me. 1981) (repossession); *In re Williams*, 6 B.R. 789 (Bankr. Ct. E.D. Mich. 1980) (repossession). Apart from the fact that the ultimate source of the creditor's right in these decisions was a consensual transaction, we find little analysis which assists us. We express no view on their correctness.

or lease under section 363. . . ." Section 363(c)(1) directs that in a Chapter 11 proceeding the trustee, without notice or a hearing, may use, sell or lease "property of the estate" in the ordinary course of business, but § 363(e) requires that "on request of an entity that has an interest in property used, sold, or leased, or proposed to be used, sold, or leased, by the trustee, the court shall prohibit or condition such use, sale, or lease as is necessary to provide adequate protection of such interest." Section 541(a)(1) provides that, with exceptions not here relevant, an estate is comprised of "all legal or equitable interests of the debtor in property as of the commencement of the case."

The Government argues that the plain meaning of these sections mandates an answer in its favor. Relying on several decisions in the district and bankruptcy courts, see footnote 1, *supra*, the Government finds in § 541's definition of "property of the estate" a distinction between a debtor's *interests in property* and *property in which the debtor has an interest*. The Government, Brief at 17, then advances the following general interpretation of the Code's turnover provision: "the 'property of the estate' which must be delivered to the trustee . . . by virtue of Section 542(a) consists only of any interests in property belonging to the debtor as of the time of its filing of a petition" in bankruptcy. The Government concludes that; at the commencement of the case, the debtor's only interests in the property seized by the IRS were those explicitly set forth in § 6331 *et seq.* of the IRC, [8] that therefore only these interests became part of the "property of the estate", and that turnover of these interests would be inappropriate since the debtor cannot "use, sell, or lease" them. Brief at 7, 18-19. All other interests in the seized property, in particular the right to

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[8] According to the Government, these were: a right to notice of the seizure and the sale, § 6335(a) and (b); a right to redemption prior to the sale, § 6337(a), and, in the case of real property, for 120 days thereafter, § 6337(b); and a right to surplus proceeds, § 6342(b).

possession, are argued to be held by the IRS. The Government draws on several general statements in the Code's legislative history to support its contention. [9]

Although there is some force in the Government's construction of §§ 542, 541 and 363, we ultimately must reject it. Justice Cardozo, interpreting one of the predecessors of the Code in *Duparquet Huot & Moneuse Co.* v. *Evans*, 297 U.S. 216, 218 (1936), said, "To fix the meaning of these provisions there is need to keep in view the background of their history. There is need to keep in view also the structure of the statute, and the relation, physical and logical, between its several parts." The mechanical interpretation of § 541(a)(1) urged by the Government would require us to violate admonition. [10]

The Government's general interpretation of the interplay of § 542 and § 541(a)(1)'s definition of "property of the estate" would have a far-reaching effect on reorganizations by denying to debtors or trustees in reorganization not only the power to

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[9] For example, the Government directs our attention to the following remarks by Representative Edwards:

> [O]nly the debtor's interest in such property becomes property of the estate. If the debtor holds bare legal title or holds property in trust for another, only those rights which the debtor would have otherwise had emanating from such interest pass to the estate under section 541.

124 Cong. Rec. H 11,096 (Sept. 28, 1978), *reprinted in* [1978] U.S. Code Cong. & Ad. News 6455.

[10] Indeed, the immediate legislative history contains language inconsistent with the rigid reading of "property of the estate" urged by the Government. The House Report accompanying the Bankruptcy Code, after noting that the "scope of [§ 541(a)(1)] is broad", states that property of the estate "includes all kinds of property, including tangible or intangible property, causes of action (see Bankruptcy Act section 70a(6) and all other forms of property currently specified in section 70a of the Bankruptcy Act § 70a, as well as property recovered by the trustee under section 542 of proposed title 11, if the property recovered was merely out of the possession of the debtor,

obtain the turnover of property of the debtor levied upon by the IRS, but also that repossessed prior to bankruptcy by secured creditors or held by pledgees after a default. In all these instances the secured creditor would have rightful possession of the property. Typical statutes recognize the debtor as having only limited "rights" in the property—notice of sale, redemption prior to sale, and receipt of surplus proceeds, see pp. 18-19 *infra* and not 8 *supra*. Thus, under the Government's reading of the statute, only these limited *interests in property* would constitute "property of the estate". The trustee therefore could obtain turnover only of these interests, which he has without benefit of a turnover order, not the property itself.

The results dictated by the Government's interpretation of § 542 would be a significant departure from the treatment of reorganization proceedings under the former Bankruptcy Act. In Chapter X reorganization cases under that Act a bankruptcy court had broad power to order secured creditors in possession following the debtor's default to turn over their collateral. In the leading case of *Reconstruction Finance Corporation* v. *Kaplan*, 185 F.2d 791 (1 Cir. 1950), a pledgee seized the debtor's plant, equipment and inventory following default on a loan, thereby precipitating the filing of a Chapter X reorganization petition later in the day. Following approval of the debtor's reorganization plan, the bankruptcy court ordered the pledgee to turn over the repossessed property to the debtor's trustee. The First Circuit, speaking through Chief Judge Magruder, upheld the order, on the ground that such

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yet remained 'property of the debtor'". Report of the Committee on the Judiciary, House of Representatives, To Accompany H.R. 8200, H.R. Rep. No. 95-595, 95th Cong., 1st Sess., at 367 (1977). This discussion indicates that § 541(a)(1) was not intended to narrow the old Act's definition of "property of the estate", as the Government's reading of the statute would require, but rather to preserve or enlarge it.

authority was necessary if Chapter X reorganizations were to have a realistic possibility for success:

> In contrast with the provisions of law relating to straight bankruptcy, Chapter X, like its earlier counterpart § 77B, . . . contemplates the rehabilitation of financially ailing business corporations under plans of reorganization which may deal with claims of creditors, secured as well as unsecured, and embrace all of the debtor's property, however encumbered with outstanding security interests. In keeping with this objective, appropriate broad powers are conferred upon the reorganization court.

185 F.2d at 794.

The court also wrote that:

> The second sentence of § 257 may not specifically authorize a turnover order displacing the ordinary possessory lien of a pledgee of collateral or other personal property; but it seems in substance to cover the kind of security interest which RFC had in the inventory under its statutory factor's lien. In other words, RFC's lien on the inventory had the characteristic of a chattel mortgage, with possession, and the right to possession, remaining in the borrower until default. *But there is no need to rest on the second sentence of § 257, which is not the broad basic section conferring upon the court jurisdiction over all the debtor's property wherever located;* it appears rather to be a specific provision inserted out of abundance of caution to make clear the inapplicability under Chapter X of Tuttle v. Harris, 1936, 297 U.S. 225, a case decided under § 77B. (Emphasis added.)

Id. at 795. [11]

The First Circuit's conclusion in *RFC* v. *Kaplan*, *supra*, was also reached in a number of other cases, some proceeding and

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[11] The fears of Congress with respect to Tuttle v. Harris, 297 U.S. 225 (1936), may well have been exaggerated. The holding in that case simply echoed that in *Duparquet*, supra, 297 U.S. 216, that appointment of a foreclosure [receiver was not an event that would authorize the commencement of a 77B] proceeding under § 77B(i). It did not deal with the power of the bankruptcy court to order a turnover by such a receiver when a 77B proceeding had been properly instituted.

others following it. See *Grand Boulevard Investment Co.* v. *Strauss*, 78 F.2d 180 (8 Cir. 1935) (under § 77B); *In re Prudence-Bonds Corp.*, 77 F.2d 328 (2 Cir.) (under ⅞ 77B), *cert. denied*, 296 U.S. 584 (1935); *John Hancock Mutual Life Insurance Co.* v. *Casey*, 134 F.2d 162 (1 Cir.) (per curiam), *cert. denied*, 319 U.S. 757 (1943); *In re Franklin Garden Apartments, Inc.*, 124 F.2d 451 (2 Cir. 1941); *In re Third Avenue Transit Co.*, 198 F.2d 703, 706 (2 Cir. 1952) (affirming bankruptcy court's authority to order turnover, but refusing to exercise discretion to do so). See also 6A Collier ¶ 14.03, at 741 (14th ed. 1977). The validity of Chief Judge Magruder's observation that this power of the bankruptcy court to order the turnover of property in the lawful possession of secured creditors did not depend solely on § 257 is demonstrated by the fact that two of these decisions were rendered under § 77B, the predecessor of Chapter X which included § 257. A principal basis of these decisions was that the reorganization statutes, § 77B(a), § 111 (Chapter X) and § 411 (Chapter XII), unlike the provisions applying in ordinary bankruptcy, but like § 77(a), see *Continental Illinois National Bank & Trust Co.* v. *Chicago, R.I. & P. Ry. Co.*, 294 U.S. 648 (1935), gave the bankruptcy court jurisdiction of all the property of the debtor, whether or not it was in the debtor's possession. [12]

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[12] There was some uncertainty as to the scope of the bankruptcy court's turnover power in Chapter XI proceedings under the former Act. According to one commentator:

> Probably the single greatest area of uncertainty with respect to the exercise of Chapter XI jurisdiction concerns the secured creditor in possession of property of the debtor. It is at present unclear whether the court has the power to prevent a secured creditor in possession from enforcing its lien and whether the court has the power to force that creditor to surrender property to the debtor.

Murphy, Restraint and Reimbursement: *The Secured Creditor in Reorganization and Arrangement Proceedings*, 30 Bus. Law. 15, 39(1974). A number of recent decisions affirmed a turnover power in Chapter XI cases similar to that under Chapter X and XII, e.g., *In re*

The Government's reading of § 541 would have the effect of reversing this settled law in reorganization proceedings under Chapter 11 of the Code. We see no evidence that any such drastic change was intended. As Justice Douglas put it, in interpreting the old Bankruptcy Act in *Emil* v. *Hanley*, 318 U.S. 515, 521 (1943), "We cannot help but think that if Congress had set out to make such a major change, some clear and unambiguous indication of that purpose would appear." We find no such indicaton in the new Code or its legislative history. And, like Justice Douglas, we do not believe that nearly fifty years of the law of reorganization under the Bankruptcy Act would have been changed without some clear statement to that effect. This is particularly true because the Government's reading of the Bankruptcy Code would seriously affect the chances of success in many reorganizations: "It is . . . generally vital to the success of a reorganization that all the debtor's property be included, that the continuation of the debtor's business be not unduly hampered by dissipation of the proper-

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George W. Schultz, 50 Am. Bankr. L.J. 185 (Bankr. Ct. D. Okla. 1975); *In re Roebling Steel & Wire Corp.*, 1 B.C.D. 944 (Bankr. Ct. D.N.J. 1975); *In re American Kitchen Foods. Inc.* 2 B.C.D. 715 (D. Me. 1976). there was, however, authority for the proposition that, since arrangements of unsecured debts under Chapter XI, unlike proceedings under Chapters X and XII, see *In re Colonial Realty Investment Co.*, 516 F.2d 154 (1 Cir. 1975), were not intended to alter the rights of secured creditors, a narrower turnover power was appropriate in Chapter XI, 8 Collier on Bankruptcy ¶ 3.02, at 156-63 (14th ed. 1977). A version of this latter view was accepted in *In re Pittsburgh Penguins Partners*, 598 F.2d 1299 (3 Cir. 1979), where the court held that in a Chapter XI proceeding the IRS could not be compelled to turn over property on which it had levied prior to the filing of a petition in bankruptcy. This decision is of little guidance in the present reorganization proceeding, both because the Third Circuit was of the view that the bankruptcy court's turnover power was extremely limited in Chapter XI cases, and because it thought that certain language in *United States* v. *Phelps*, *supra*, was dispositive of the case before it, a view we do not share, see pp. 23-24, infra.

ty to particular creditors. . . ." 6 Collier on Bankruptcy ¶ 3.05, at 431 (14th ed. 1977). In light of legislative history indicating that reorganizations were to be encouraged under the new Code, we doubt that Congress intended such a result. [13]

Indeed an examination of the legislative history antedating 1977 compels a broad view of § 542's turnover power. Section 542 was a relatively late addition to the Code. It did not appear in the early drafts of the proposed legislation, [14] and was first included in H.R. 6, which was introduced on Jan. 4, 1977.

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[13] See the remarks of Representative Edwards quoted in text at pp. 25-26, *infra*. According to Chairman Rodino, of the House Judiciary Committee. "[f]or business, the bill facilitates reorganizations, protecting investments, and jobs." 123 Cong. Rec. H. 11,697 (daily ed. Oct. 27, 1977).

[14] By early we mean H.R. 10,792, introduced Oct 4, 1973; S. 2565, introduced Oct. 11, 1973; H.R. 16,643, introduced Sept. 12, 1974; H.R. 31; H.R. 32; S. 235; and S. 236. See Klee, Legislative History of the New Bankruptcy Code, 54 Am. Bankr. L.J. 275, 280 (1980).

> The provision that came the closest to creating a general turnover power was § 4-603, which was a "custodian" turnover section similar to what is now § 543; Sec. 4-603. EFFECT OF FILING OF PETITION ON PRIOR CUSTODIAN OF DEBTOR'S PROPERTY.—
>
> (a) APPLICABILITY OF SECTION.—If when a petition is filed under this title the property of the debtor is in the possession of —
>
> (1) a receiver, trustee, or other officer of a nonbankruptcy court, or
> (2) an assignee under a general assignment for the benefit of creditors, or
> (3) a trustee or agent under a statute or contract who is appointed or authorized to take charge of the property of the debtor or of a general administration of the debtor's property for the benefit of creditors,
>
> the custodian's rights and duties respecting the property shall be governed by this section.
>
> (b) DUTY OF CUSTODIAN TO DELIVER PROPERTY AND MAKE ACCOUNTING.—A custodian of the debtor's property to whom this section applies shall deliver the property in his possession to the trustee of the debtor's estate under this title

H.R. 6 was the product of the House Judiciary Committee, which prepared the bill after the Subcommittee on Civil and Constitutional Rights had conducted extensive hearings on earlier drafts. [15] H.R. 6 was prepared with the intent of resolving problems that had been identified during these hearings. 124 Cong. Rec. H 11690, 11701; Klee, *Legislative History of the New Bankruptcy Code*, 54 Am. Bankr. L.J. 275, 280 (1980). Since § 542 first appeared in H.R. 6, it is important to consider what was said at those hearings regarding the turnover of collateral from secured creditors in possession.

The House and Senate subcommittee hearings contain a number of statements regarding the bankruptcy court's turnover power. The following pattern emerges from the testimony: Witnesses said it was clear that the bankruptcy courts were intended to have (and should have) the authority to order the turnover of collateral from secured creditors in possession. Concern was expressed, however, that the language of early drafts of the proposed legislation failed to set forth the basis for such a turnover power in sufficiently explicit detail; consequently, redrafting of the legislation on this point was urged. Witnesses also suggested that turnover be preceded by the provision of adequate protection for secured creditor's interests. We are not aware that any witness opposed a broad turnover power if this was accompanied by proper provisions for protection.

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and shall account to the administrator for the disposition of the property received as such custodian unless—

(1) the prior custodian took possession of the property for the purpose of general administration of the debtor's estate more than three months prior to the filing of a petition for relief under chapter V of this title: . . .

H.R. 31, § 4-603. H.R. 32, S. 235, and S.236 all contained almost identical provisions.

[15] The House hearings involved some 100 witness, whose testimony fills some 2,800 pages plus appendices.

The following excerpts from the congressional hearings illustrate the above summary. One witness told the House subcommittee:

> I believe that it is almost beyond argument that in the new bankruptcy legislation collateral in the possession of secured creditors should be subject to the jurisdiction of the bankruptcy court, except, perhaps, where the bankruptcy is directed toward liquidation and the property has already been taken into custody by another court of competent jurisdiction. . . .
>
> In rehabilitative proceedings it is proper for the court to be able to control under the injunctive power liquidation procedures by secured creditors in possession *and under adequate safeguards to compel the surrender of collateral for use in the rehabilitation process. While recognizing the wish of this Committee that witnesses not comment on the specific language of the proposed legislation at this time I note that the power of the court to compel the surrender of collateral has been left largely to inference in both of the Bills presently before Congress. Leaving this issue to case by case development is, in my opinion, undesirable in light of the present judicial uncertainty on the point and I believe that the legislation should expressly deal with the question of when and under what standards displacement of the secured creditor or its agent should be permitted.*

Subcommittee on Civil and Constitutional Rights of the House Committee on the Judiciary, Bankruptcy Act Revision, 94th Cong., 1st Sess., Hearings on H.R. 31 and 32, Part I, at 439 (1976) [hereinafter House Hearings] (prepared statement of Patrick A. Murphy, Esq.) (emphasis added). See also *Id.* at 489-93.

Another witness, testifying on behalf of the American Bankers Association, said:

> A related change in both bills would extend the jurisdiction of the Bankruptcy Court to secured creditors in possession of property of the bankrupt, which would, with appropriate safeguards, permit the Bankruptcy Court to force the secured creditor to surrender that property to the debtor or trustee even in a straight bankruptcy case. Assuming that adequate safeguards of the rights of se-

> cured creditors are contained in the legislation, we would support this change recognizing that is is a power that is present in reorganization cases under existing law [citing §§ 256 and 257 of Ch. X and §§ 506 and 507 of Ch. XII and *RFC* v. *Kaplan.]* It should be made clear by statute, however, that the Bankruptcy Court would have no power to administer any secured creditor's collateral unless (1) there is an equity for the benefit of creditors or unless such administration is necessary to effect a rehabilitation under Chapter VI or VII of the Commission's Bill or Chapters VI, VII, or VIII of the Judge's Bill, and (2) it is clear that the value of the secured creditor's claim against the collateral will be preserved.

Id. at 1023 (prepared statement of Walter W. Vaughn).

The National Bankruptcy Conference expressed the same view of the matter:

> However, the NBC [National Bankruptcy Conference] noted that there is no provision either in the reorganization chapter or elsewhere comparable to existing Section 257 of Chapter X. This Section authorizes the Court to require a mortgagee or other secured creditor to turn over to a trustee property in his possession. In view of the expanded jurisdiction of the Bankruptcy Court under the proposed bills, it is also clear that this power should continue in the Court and the NBC concluded that it should be extended to liquidation cases.
>
> The following principles are therefore recommended: (1) the right to gain possession from a secured creditor should exist in both liquidation and reorganization cases. (2) Some standard or guidelines, even if only of a general nature should be established as to the occasions when such rights should be exercised. (3) The standards or guidelines in liquidation cases should be those contained in Section 5-203 and in reorganization cases those in Section 7-203 [the forerunner of the current adequate protection section].

Id. at 1838-39. [16] See also *Id.* at 1756-57 (prepared statement of Robert J. Grimmig, Vice-President, Chemical Bank); Subcommittee on Improvements in Judicial Machinery of the Senate Committee on the Judiciary, The Bankruptcy Reform Act, Hearings on S. 235 and S. 236, Part I, at 125 (statement of Walter Vaughn) and 464 (statement of Robert Grimmig) (1976).

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[16] The revision suggested by the National Bankruptcy Conference would have amended § 4-603 of H.R. 31 and 32 (quoted at not 14, *supra*) as follows:

> Section 4-603. Effect of Filing of Petition on Prior Custodian of Debtor's Property *and Creditor in Possession.*
>
> (a) Applicability of Section. If when a petition is filed under this Act [the]property of the debtor is in the possession of:
>
> (1) a receiver, trustee, or other officer of a nonbankruptcy court, or
>
> (2) an assignee under a general assignment for the benefit of creditors, or
>
> (3) a trustee or agent under a statute or contract, who is appointed or authorized to take charge of the property for the purpose of enforcing a lien against the property of the debtor or of a general administration of the debtor's property for the benefit of creditors, or
>
> (4) *a creditor*
>
> the custodian's *or creditor's* rights and duties respecting the property shall be governed by this section.
>
> (b) *Duty of Custodian or Creditor to Deliver Property and Make Accounting.* A custodian [of the debtor's property] or creditor to whom this section applies [shall] *may be directed by the court to deliver the property in his possession to the trustee of the debtor's estate under this Act [and] for the purpose of sale under section 5-103 in a case under Chapter V, for the purpose of sale returning the property to the debtor subject to any relief from the stay prescribed by section 4-501 in a case under Chapter VI, or for the purposes of use pursuant to section 7-203 or disposition pursuant to section 7-104, 7-205, or 7-303(9) in a case under Chapter VII or IX.*

A Note prepared by the NBC to accompany the proposed change read:

The proposed addition to the title of the Commission's §4-603 and the proposed addtion of clause (4) to subsection (a) are designed to make clear that the section applies to a mortgagee or other creditor in posssession of some or all of the property of the debtor as do §§ 257 and 507 of the present Act. *In re Colonial Realty Investment Co.*, 516 F.2d 154 (1st Cir. 1975); *In re Franklin Garden Apartments.* 124 F.2d 451 (2d Cir. 1941).

Commentary on the proposed bankruptcy legislation reflected the same understanding. One article, Murphy, *Use of Collateral in Business Rehabilitation: A Suggested Redrafting of Section 7-203 of the Bankruptcy Reform Act*, 63 Calif. L. Rev. 1483 (1975), said:

> Two questions are presented: (1) does the court have the power to stay the secured creditor from commencing or continuing a foreclosure action; and (2) does the court have the power to order a secured creditor in possession to surrender the property for use in the rehabilitative process? Section 7-203 of the Proposed Act contemplates the use of collateral but fails to deal with the initial question of obtaining the property from a secured creditor in possession. Section 2-201 of the Proposed Act is clearly intended to extend the jurisdiction of the court to property of the estate whereever located and, when read with section 4-501, would permit the court to *stay* a secured creditor in possession even in straight bankruptcy proceeding—clearly a change from existing law. However, neither the Proposed Act nor the Judge's Bill deals expressly with the *recovery* of property from secured creditors in possession.

Id. at 1497 (footnotes omitted). The article continued:

> Expanded jurisdiction under section 2-201, in combination with the broad definition of "property of the estate" under section 4-601, indicates that the Commission intended to give the court power to deal with collateral in the possession of secured creditors. This should be clarified, however, in the general part of the legislation, Chapter IV of the Proposed Act, rather than in Chapter VII, in order for the court to have comprehensive power in liquidation proceedings and in the rehabilitative chapters.

Id. at 1497-98. See also Coogan, *Comments on Some Reorganization Provisions of the Pending Bankruptcy Bills*, 30 Bus. Law. 1149, 1169-78 (1975); Murphy, *Restraint and Reimbursement: The Secured Creditor in Reorganization and Arrangement Proceedings*, 30 Bus. Law 15 (1974).

Shortly after the uncontradicted statements regarding the bankruptcy court's turnover power, cited above, were made to the House and Senate subcommittees, § 542, the Code's general turnover provision, was added to the proposed legislation.

Following this addition, the provision was incorporated in all later drafts of the bill, and the turnover question, which had attracted substantial attention in the 1975 and 1976 hearings, was not mentioned in subsequent legislative history. This sequence of events compels the inference that § 542 was added to the Code to make clear—as a number of witnesses had explicitly urged—that the turn-over power approved in *RFC* v. *Kaplan* was to be incorporated in the new statute. This inference becomes all the more compelling when one considers that if § 542 did not authorize compelling turnovers by secured creditors in possession, apparently its only use would be to authorize obtaining property from persons in wrongful possession following theft or conversion. Given the circumstances surrounding the inclusion of the section in the Code, the more natural reading of § 542 is that it was intended to codify *RFC* v. *Kaplan*, and possibly, although we need not decide the question, also extend the turnover power to straight bankruptcy cases.

For the foregoing reasons, we reject the Government's reading of §§ 542, 541 and 363 in the present context of a Chapter 11 proceeding, and hold that in such a case the bankruptcy court generally has power under § 542 to order the turnover of property repossessed or executed upon by a secured creditor or held by a pledgee following the debtor's default and prior to his bankruptcy, if the property has not yet been sold. We thus pass on to the Government's further argument that, even if the bankruptcy court can compel a turnover by a repossessing or executing lender under § 542 in a Chapter 11 proceeding, this cannot be done in the case of property upon which the IRS had levied.

III. *Federal Tax Levies*

On the basis of a mere reading of the IRC provisions, the argument is unpersuasive. Comparison of relevant statutes indicates that an IRS levy on tangible property pursuant to § 6331 *et seq.* is virtually indistinguishable from the ordinary repossession and foreclosure procedures followed by secured creditors, except for the fact that the IRS can make its own

levy without need of the assistance of a sheriff, marshal or similar officer. Compare § 6331 *et seq.* of the IRC with §§ 9-207. 9-501 to 507 of the UCC and with N.Y. Lien Law §§ 200-05 (public sales), N.Y. Lien Law §§ 206-210 (levy) and with §§ 1301 *et seq.* of the New York Real Property Actions and Proceedings Law. In these instances as under IRC § 6331 *et seq.*, the statutes give the debtor the right, and only the right, to notice, an opportunity for redemption, and surplus proceeds.

The Government's argument for a sharp distinction between an IRS levy and a secured creditor's repossession is based primarily on *Phelps* v. *United States*, 421 U.S. 330 (1975). In *Phelps*, a taxpayer had transferred its assets to an assignee for the benefit of creditors, who had converted them into some $38,000 in cash. The Government filed a notice of tax lien in the amount of $140,831.59 and levied upon the $38,000 in the assignee's hands. An involuntary petition in bankruptcy was then filed against the taxpayer, and a receiver in bankruptcy petitioned the bankruptcy court to require the assignee to turn over the proceeds. The Seventh Circuit ruled against the receiver, 495 F.2d 1283 (1974), on the ground that the assignee was holding for the benefit of the United States as an adverse claimant, thereby implicating the rule that in ordinary bankruptcy such a holder is not subject to summary jurisdiction. It disagreed with the Ninth Circuit's decision in *In re General Wood Products Corp.*, 483 F.2d 975 (1973), that an assignee's disclaimer of interest brought similarly seized property within the summary jurisdiction of the bankruptcy court under language in *Taubel-Scott-Kitzmiller Co.* v. *Fox*, 264 U.S. 426, 432-33 (1924), and that the possession of the bankrupt necessary to support exercise of summary jurisdiction in ordinary bankruptcy existed "where the property is held by some other person who makes no claim to it." The Supreme Court granted certiorari to resolve the conflict.

The Supreme Court agreed with the Seventh Circuit. It reasoned that, following the levy, the assignee held the $38,000 on behalf of the United States as an adverse claimant. The Court then applied the settled rule that "where possession is

assertedly held not for the bankrupt, but for others prior to bankruptcy . . . the holder is not subject to summary jurisdiction." *Phelps*, *supra*, 421 U.S. at 335-36 (quoting 2 Collier on Bankruptcy ¶ 23.06[3], at 506.2-506.3 (14th ed. 1975)). The receiver's case was not aided by § 2a(21) of the Bankruptcy Act which authorized bankruptcy courts to require turnovers by assignees for the benefit of creditors since, as a result of the levy, the assignee was holding not for creditors generally but as a custodian for the United States.

It is plain that the *holding* in *Phelps* does not assist the Government here. *Phelps* was one in the line of cases applying the distinction between summary and plenary jurisdiction that had evolved under the 1898 Act with respect to ordinary bankruptcy, see *Taubel-Scott-Kitzmiller Co.* v. *Fox*, *supra*, 264 U.S. 426, where decision hinged on whether or not the trustee had actual or constructive possession of the debtor's property. Under the Code this distinction no longer exists, as the legislative history makes clear, see, e.g., Senate Report No. 95-989 (1978) at 153, *reprinted in*, [1978] U.S. Code Cong. & Ad. News 5939; House Report No. 95-595 (1978) at 445, *reprinted in*, [1978] U.S. Code Cong. & Ad. News 6400. Instead, Congress adopted a broad jurisdictional provision which states, in language modeled on § 111 of Chapter X of the former Act, "The bankruptcy court . . . shall have exclusive jurisdiction of all of the property, wherever located, of the debtor, as of the commencement of [the] case." 28 U.S.C. § 1471(e). Hence it is far from clear that under the Code a bankruptcy court would not have *power* to order a turnover on the same facts as in *Phelps*. [17]

Moreover *Phelps* did not decide that a bankruptcy court would not have had power in a Chapter X proceeding under the former Act to direct a turnover on facts such as there presented. As we have previously developed, the constraints

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[17] We emphasize the word "power" since it is hard to see what proper purpose a turnover would have in straight bankruptcy on the facts of *Phelps*.

against a bankruptcy court's exercising summary jurisdiction with respect to property of the bankrupt not in the debtor's actual or constructive possession had never applied under the reorganization provisions, §§ 77 and 77B, and Chapters X and XII. Rather, "the reorganization court [could] bring its authority to bear upon creditors in situations not possible in ordinary bankruptcy." 6 Collier on Bankruptcy ¶ 3.03, at 412 (14th ed. 1977). In such cases

> when possession of the debtor's property is held by a creditor, such as a pledgee or mortgagee, whose claim is not in dispute and who does not dispute the debtor's title but claims the right to hold the property and use it as security, the courts have generally ruled that this possession is not sufficient to defeat the reorganization court's summary jurisdiction either to enjoin the use of the security as by sale or to retake possession thereof.

6 Collier on Bankruptcy ¶ 3.05, at 431 (14th ed. 1977). See *Reconstruction Finance Corporation* v. *Kaplan*, *supra*, and cases cited at pp. 11-12, *supra*. As shown above the framers of the Code intended to preserve this jurisdiction.

The Government is thus forced to argue that after an IRS levy, as distinguished from levies by other secured creditors, a debtor loses not only possession but ownership. This position finds scant support in the language of IRC § 6331 *et seq*. Looking only at the statute, we would see no basis for doubt that at the commencement of the Chapter 11 proceeding Whiting had title to the goods the IRS had seized. Under the statute ownership is extinguished not by the levy and seizure but only by a subsequent sale. Thus, § 6335(a) requires that written notice of seizure be given "to the owner of the property (or, in the case of personal property, the possessor thereof)" or be left at his usual place of abode or business. Section 6335(b) requires that, as soon as practicable after the seizure, notice of sale be given to "the owner". Section 6336, relating to perishable goods, again requires notice to the "owner of the property". The IRS's certificate of sale of personal property shall "transfer to the purchaser all right, title, and interest of the party delinquent in and to the property sold", § 6339(a)(2), and its deed of real

property "shall be considered and operate as a conveyance of the right, title and interest the party delinquent had in and to the real property thus sold at the time the lien of the United States attached thereto." § 6339(b)(2). By the very language of the statute, it is the delinquent party's interest, not an interest already acquired by the Government as a result of the levy, that is conveyed. Nothing in these sections prohibits the delinquent party, after the levy and pending the sale, from exercising the most fundamental right of ownership, namely, to transfer title, subject, of course, to the continuing right of the United States to proceed with the sale unless the property has been redeemed under § 6337(a). Such a transfer could well occur when the taxpayer's equity was substantial. It thus is not surprising that in *Bennett* v. *Hunter*, 76 U.S. (9 Wall.) 326, 336-37 (1870), addressing itself to a statutory scheme essentially the same as IRC § 6331 *et seq.*, the Court had said:

> What preceded the sale was merely preliminary, and, independently of the sale, worked no divestiture of title.

The title was "forfeited" by the levy only in the sense that "it became subject to be vested in the United States, and upon public sale, became actually vested in the United States or in any other purchaser, but not before such public sale."

In the face of all this the Government relies on two statements in the *Phelps* opinion. One, 421 U.S. at 337, is that "The levy, therefore, gave the United States full legal right to the $38,000 levied upon as against the claim of the petitioner receiver". The statement that the United States had "full legal right" to the $38,000 levied upon for a much larger tax liability is not equivalent to saying that where, as here, the debtor has an equity in the property, that also passes to the Government. Any such statement—and, we repeat, none was made—not only would have been unnecessary to the decision but would have run directly counter to *Bennett* v. *Hunter*, *supra*, which was not called to the Court's attention either in the briefs or in oral argument and was not cited by it.

The other statement in *Phelps* on which the Government relies is in footnote 8, 421 U.S. at 337. The footnote dealt with

an argument by the receiver based on § 70a(8), which vested a trustee in bankruptcy "with the title of the bankrupt as of the date of the filing of the petition . . . to . . . property held by an assignee for the benefit of creditors." The Court's first answer was the receiver's admission that at the date of the filing of the petition, the bankrupt had no title to property it had previously conveyed to the assignee. The footnote then added:

> In any event, the pre-bankruptcy levy displaced any title of Chicagoland [the taxpayer], and § 70a(8) is therefore inapplicable.

The footnote cited no authority for the proposition that the levy as distinguished from the sale "displaced" the title of Chicagoland, which the receiver had conceded to be non-existent because of the prior conveyance to the assignee, and any such view, if applied generally, would run directly counter to *Bennett* v. *Hunter*, *supra*. The remark just quoted must be read as addressed to the particular circumstances of the *Phelps* case, where the tax claim vastly exceeded the amount of the levy and the seizure was of cash which did not need to be sold. See *United States* v. *Pittman*, 449 F.2d 623, 627 (7 Cir. 1971). [18]

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[18] The Government relies also on cases in the courts of appeals to support its thesis that a levy under § 6331 *et seq.* strips the debtor of ownership despite the contrary implications of the statutory language and *Bennett* v. *Hunter*, *supra*. The general thrust of the decisions, as distinguished from some of the language, is to the contrary. *In re brewster-Raymond Co.* 344 F.2d 903 (6 Cir. 1965), held that a debt owing to the bankrupt on which the Government had levied prior to adjudication but the proceeds of which had not been turned over to it remained part of the bankrupt estate so as to trigger § 57j, which prohibited the collection of tax penalties that had been included in the levy. United States v. Sullivan, 333 F.2d 100 (3 Cir. 1964) (in banc), although paraphrasing, at p. 116, the language in *United States* v. *Eiland*, 223 F.2d 118, 121 (4 Cir. 1955), a case cited in *Phelps*, 421 U.S. at 336, that a levy "effects a seizure of the deliquent's property tantamount to a transferal of ownership", held

In deciding this case it is appropriate for us to look, as the Supreme Court would equally be obliged to look, not only to the two statements in *Phelps* but to the legislative history of the Bankruptcy Code. Both the House and the Senate Reports, H.R. Rep. No. 95-595, 95th Cong. 1st Sess. at 367 (1977); S. Rep. No. 95-989, 95th Cong. 2d Sess. at 82 (1978), said that § 541(a) included

> property recovered by the trustee under section 542 of proposed title 11, if the property received was merely out of the possession of the debtor, yet remained property of the debtor.

and that

> The debtor's interest in property also included "title" to property, which is an interest, just as are a possessory interest, or a leasehold interest, for example.

Despite the Government's assertions to the contrary, our conclusion that an IRS levy on tangible property in which the debtor has an equity does not strip the debtor of all property interests and transfer full title to the Government is entirely consistent with the statements in the House and Senate Re-

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that the levy did not allow the Government to recover from insurance policy loans and automatic premium loans made after service of the notice of the levy. *Eiland* itself held only that in an ordinary bankruptcy a referee could not compel a debtor of the bankrupt on whose debt the United States had levied for a much larger tax to pay the debt to the trustee rather than the United States; the court suggested that a different result might obtain if the case involved tangible property, 223 F.2d at 123. *United States* v. *Pittman*, *supra*, 449 F.2d 623, while presenting textual arguments that, in its view although not in ours, would support a conclusion that the levy itself transferred title to the Government and citing *Eiland*, *supra*, ended up by saying, at p. 627:

> *Eiland* involved the levy upon an intangible indebtedness rather than upon corporeal property as here and we would hesitate to extend its holding. Such a step is not necessary to the decision of this case.

ports, H.R. Rep. No. 95-595, *supra*, at 367-68; Sen. Rep. No. 95-989, *supra*, at 82, see also 124 Cong. Rec. H 11096 (daily ed. Sept. 28, 1978), that the Code was "not intended to expand the debtor's rights against others more than they exist at the commencement of the case" and that the trustee "could take no greater right than the debtor himself had." Whiting has not asked us to invalidate the tax lien. It has asked only to have the use of the property, on which the IRS had levied but which it had not yet sold, in what Whiting believed and the bankruptcy judge found might be a successful rehabilitation, to the advantage of the Government as well as other interested parties. Here we must give some weight to the purpose of the Code, announced by Representative Edwards, a member of the Commission on the Bankruptcy Laws of the United States, who presented the bill to the House, 124 Cong. Rec. H 11089 (daily ed. Sept. 28, 1978):

> The amendment also encourages business reorganizations by a streamlined new commercial reorganization chapter. . . . It will protect the investing public, protect jobs, and help save troubled businesses.

There can be no doubt that allowing the government to strip a failing company of all its tangible property would impact seriously on this goal. [19]

We recognize that, as said in *Bull* v. *United States*, 295 U.S. 247, 259-60 (1935), "taxes are the life-blood of government, and their prompt and certain availability an imperious need. Time out of mind, therefore, the sovereign has resorted to more drastic means of collection. The assessment is given the force of a judgment, and if the amount assessed is not paid when due, administrative officials may seize the debtor's property to satisfy the debt." Such considerations are of peculiar force

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[19] For the impact of IRS levies upon businesses seeking to reorganize, see Nowak. *Turnover Following Prepetition Levy of Distraint Under Bankruptcy Code § 542*, 55 Am. Bankruptcy L.J. 313, 313-14 (1981) (citing findings of Senate subcommittee investigation of IRS collection efforts).

when, as here, a debtor has simply helped itself to amounts withheld from employees. The framers of the Code sought to reconcile the possibly conflicting goals of enhancing the prospects for rehabilitation and protecting the revenue by the provision in § 363(e) for adequate protection of the subject of a turnover order to which we have already referred, *supra*, note 3. The nature of what § 363(e) means by "adequate protection" is spelled out in § 361, quoted at note 3, *supra*. If a plan of reorganization is ultimately effectuated, the United States, as holder of a perfected lien, would be entitled to the protections afforded by § 1129(b)(2)(A); it could not be treated, over its objection, simply as an unsecured priority creditor. However, a successful reorganization is by no means assured; there have been all too many instances where creditors, even secured creditors, have seen their interests whittled away while the debtor and its counsel endlessly pursue some will of the wisp after all real hope has faded. A bankruptcy judge acting on a request like that made here should therefore give serious consideration to forms of protection other than that ultimately obtainable in a reorganization plan. [20]

Here the bankruptcy judge purported to do just that, see note 5, *supra*, and we would have little doubt that the conditions he developed would be sufficient except for one point not apparent on the face of his opinion. The opinion of the district court reveals that, in addition to the turnover order of April 28, 1981, here before us, the bankruptcy judge made an order on April 30, 1981, directing Bankers Trust Company to pay certain levied funds to the IRS and further directing that such funds [21] be considered as partial payment of the $20,000 which Whiting was required to pay the IRS under the order

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[20] The judges must also vigilantly monitor the results of business operations and the progress of attempts at reorganization.

[21] The Government tells us, Brief at 5, fn. 3, that these amounted to nearly $15,000. It objects to the consideration of such funds, which it deems to be its own, as part of the down payment.

here under review. The district judge vacated the April 30 order and directed the bankruptcy court to reconsider it. We are not clear what the effect of this was. There is nothing to indicate whether Whiting had appealed from the April 30 order, and the direction that the Bankers Trust funds be considered as partial payment of the $20,000 on the turnover of the tangibles would fade away if the April 28 order were vacated as the district court directed. The April 30 order is not before us and perhaps may never be. We also have no idea what has been happening in the year since the levy and the filing of the Chapter 11 petition. Under the circumstances we think it best simply to reverse the order of the district court insofar as it held that the tangible assets were not subject to a turnover order, and remand to it with instructions to vacate its own order to that effect and remand to the bankruptcy court for further proceedings consistent with this opinion. In such proceedings the bankruptcy court should consider whether a turnover order is appropriate under present circumstances and, if it decides in the affirmative, what protection should be afforded to the United States.

It is so ordered.

APPENDIX B

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NEW YORK

CASE NO. 81-20063
81-2034A

In re

WHITING POOLS, INC.,

Debtor.

UNITED STATES OF AMERICA,

Plaintiff,

vs

WHITING POOLS, INC.,

Defendant.

MEMORANDUM AND DECISION

The United States of America has commenced an action under 11 U.S.C. § 362(d) of the new Bankruptcy Code seeking a determination that the automatic stay provisions of Bankruptcy Code 11 U.S.C. § 362(a) are not applicable to it with respect to certain property seized by the Internal Revenue Service from Whiting Pools, Inc. to satisfy unpaid employment taxes; or alternatively, seeking relief from the automatic stay provisions of 11 U.S.C. § 362 to permit the Internal Revenue Service to sell the seized property. A preliminary hearing was held within 30 days after the filing of the complaint and was continued to a final hearing. The final hearing has been held. Both parties have submitted memorandums of law and all testimony has been taken.

From the hearings, the facts appear to be as follows. Whiting Pools, Inc. filed a petition under Chapter 11 of the Bankruptcy Code on or about January 15, 1981. Whiting Pools, Inc., the debtor in this proceeding, is engaged in the business of selling, installing and servicing swimming pools. It also retails

pool equipment and supplies from its place of business at 7244 Palmyra Road, Fairport, New York. On January 14, 1981, the United States acting through the Internal Revenue Service seized all of the debtor's property at its place of business. The seizure included nearly all of the debtor's tangible property. The United States proposes to sell this property at public auction or otherwise in accordance with sections 6331 *et. seq.* of the Internal Revenue Code. It is seeking the permission of this Court to conduct such a sale. The property seized includes equipment, vehicles, inventory, office equipment and supplies. The United States claims to be owed approximately $92,000 in back employment taxes.

The issues presented to the Court are: First, can the Internal Revenue Service proceed with its sale of the seized property without permission of the Bankruptcy Court; second, if the Service is bound by the provisions of 11 U.S.C. § 362(a), should the stay be lifted pursuant to § 362(d); and third, if the stay is continued, can this Court order the Service to turnover the seized property to the debtor so that rehabilitation of the debtor can be effected. Each of these issues will be addressed in turn.

Whether the Service needs permission of this Court to proceed with its sale of the debtor's property depends on the applicability of the automatic stay provisions of 11 U.S.C. § 362. Section 362(a) provides in pertinent part as follows:

> 362(a) Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title operates as a stay, applicable to all entities, of-
>
> (5) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title:
>
> (6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title . . .

The automatic stay applies to the Service under either of these paragraphs. The seized property, although in the custody of the Service, is, nevertheless, property of the debtor. Title to the property never passed to the Service or to anyone

else. Any doubt about the debtor's continued ownership of the property is soon dispelled upon the reading of § 6335 of the Internal Revenue Code of 1954 which provides for the sale of seized property. That section repeatedly refers to the taxpayer as the *owner* of the property. Therefore, paragraph 5 clearly applies in this case. Furthermore, even if the seizure had divested the debtor of title to the property, paragraph 6 would prevent the Service from unilaterally exercising its right to sell the property since such a sale would constitute an act to collect a claim against the debtor. *See In re Avery Health Center, Inc.*, Civil Action No. 81-51E, BK 81-10130, 3 CBC 728 (W.D.N.Y. Jan. 28, 1981).

Having decided that the automatic stay is applicable to the Service with respect to the seized property we must now consider whether the stay should be continued or lifted. Here, the relevant section of the Code is § 362(d) which provides as follows:

> 362(d) On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay-
>
> (1) for cause, including the lack of adequate protection of an interest in property of such party in interest; or
>
> (2) with respect to a stay of an act against property, if-
>
> (A) the debtor does not have an equity in such property; and
>
> (B) such property is not necessary to an effective reorganization.

It is readily apparent that the Service cannot succeed in lifting the stay under paragraph 2. The hearings required by 11 U.S.C. § 362(d) have been held and this Court finds with regard to those hearings that the property of the debtor is worth $162,876 as a going concern and that the only liens against that property are a tax lien of $92,000 and Marine Midland's security interest which is either $6,000 or $12,500 depending upon the outcome of litigation which involves par-

ties not before this Court. Thus, the provisions of subparagraph A are not met since the debtor has substantial equity in the property.

Furthermore, the seized property is absolutely necessary to an effective reorganization of the debtor. The Service has seized virtually everything this debtor owns. If the stay is lifted and the sale occurs, the debtor will cease to exist. Therefore, even if the debtor had no equity in the seized property, the stay could not be lifted pursuant to paragraph 2 since the provision of subparagraph B cannot be satisfied.

Therefore, the Service must show cause, pursuant to paragraph 1, why the stay should be lifted. The sole cause advanced by the Service is that the United States is incurring rent of $2,500 per month while it waits to sell the property.

Taking into account the testimony adduced by the Service, their forced sale (the proceeds of which are subject to prior lien) will probably net a maximum of $30 to $35,000 and the more probable recovery will be in the neighborhood of $20,000. The extra expense incurred as a result of the stay of sale is substantial in light of the minimal recovery expected from the forced sale.

Significantly, the Service has not argued that it lacks adequate protection for the harm wrought by the imposition or continuation of the stay. Apparently, the reason for this is that a business without access to its property is in no position to offer such protection and it would be inconsistent for the Service to hold the property and demand protection at the same time.

It is abundantly clear to this Court that the United States' interest in the property can adequately be protected if the debtor's property is returned to it and its business is recommenced. This Court also feels that such a turnover is in the best interests of both parties and would accomplish the purpose of both the Bankruptcy and Internal Revenue Codes. The United States can realize more on its tax claim from the income of a revitalized business than from the proceeds of a forced sale. Nevertheless, the Service insists that it be permitted to sell the property at auction and further insists that this Court

cannot order a turnover of pre-petition seized property. Since it makes little sense to continue the stay unless a turnover of property can accompany the stay, we now turn to the most critical issue of this case; *i.e.*, the power of a Bankruptcy Court to order the turnover of property in the hands of a creditor incident to the enforcement of a lien.

To begin with, the question of whether property seized by the Service prior to the filing of a bankruptcy petition is property of the estate as defined by § 541 of the Code and thus subject to the turnover provisions of § 542 has already been addressed in this district. *In the Matter of Avery Health Center, Inc.*, 3 CBC 728 (W.D.N.Y. 1981) Judge Elfin concluded that only those property interests remaining in the debtor at the time it filed its petition could be considered property of the estate as defined by § 541. Having found that the debtor was not entitled to use, lease, or otherwise possess the seized property at the time it filed its petition, Judge Elfin held that "the IRS may not be ordered to turn over the levied property under § 542 of the Bankruptcy Code." *Id* at 732.

Judge Elfin approached the problem by considering in turn § 542, § 363 and § 541. His attention was focused primarily on § 541 and he held close to the clear, plain and literal terms of that section. Simple logic, operating on the plain language of the Code and the information available to him, necessarily led him to the conclusion he reached.

This Court cannot argue with Judge Elfin's logic but neither can it accept an interpretation of the Code that strips a reorganization court of the power to order a turnover of pre-petition seized property necessary to the successful rehabilitation of Chapter 11 debtors. Such power was lodged in this Court under the Act and Congress could not have intended to limit that power when it enacted the Code.

Under the Act, the source of the Court's power to order the turnover of property was § 2(a)(21), which, in Chapter X cases, was supplemented by § 257. Clause 21 required receivers or trustees appointed in other proceedings, assignees for the benefit of creditors and liquidation agents to turnover to the trustee in bankruptcy all property that was the property of the

debtor before it came into the hands of such receiver, trustee or assignee.

In cases arising under this section, the courts distinguished between "equity receivers" and "foreclosure receivers". *See Emil* v. *Hanley*, 311 U.S. 515 (1942) and *Tuttle* v. *Harris*, 297 U.S. 225 (1935). Essentially, the former was a receiver, trustee, assignee or agent who held the debtor's property for the benefit of creditors generally. The latter were entities who had possession of the debtor's property incident to the enforcement of a lien.

Another distinction drawn, not only by the courts but by the Act itself, was the different treatment of property in the hands of a "foreclosure receiver" depending on whether the proceedings at bar contemplated reorganization or straight bankruptcy. In straight bankruptcy, only property in the hands of an "equity receiver" was subject to the turnover provisions of § 2(a)(21), *Emil* v. *Hanley*, *supra*. Property held by or for a creditor incident to the enforcement of a lien was not reachable by the trustee in bankruptcy unless he could successfully challenge the validity of the underlying lien in a plenary suit. *Phelps* v. *United States*, 421 U.S. 330 (1975).

On the other hand, in reorganization cases, § 2(a)(21) was read in conjunction with § 257. Section 257, which applied only to Chapter X cases, provided:

> § 257. The trustee appointed under this chapter, upon his qualification, or if a debtor is continued in possession, the debtor, shall become vested with the rights, if any, of such prior receiver or trustee in such property and with the right to the immediate possession thereof. *The trustee or debtor in possession shall also have the right to immediate possession of all property of the debtor in the possession of a trustee under a trust deed or a mortgagee under a mortgage.* (Emphasis added)

It was the intent of Congress in enacting this section to make clear the inapplicability under Chapter X of the equity-foreclosure distinction. *Reconstruction Finance Corp.* v. *Kaplan*, 185 F.2d 791, 795 (1st Cir. 1950). Thus, in reorganization cases, not only was property in the hands of an "equity receiver" subject to the turnover provisions of § 2(a)(21) but so also was

the property in the possession of "foreclosure trustees". *Emil* v. *Hanley, supra* at 522. The reason for this is obvious. In order to undertake successfully the rehabilitation of a corporate debtor it was necessary that a reorganization court be empowered to take possession of all the debtor's property wherever located and regardless of the nature of the debtor's possession. *See generally*, Collier (14th Ed.) ¶ 14.03; *see also*, *In Re Prudence-Bonds Corp.*, 77 F. 2d 328 (2d Cir. 1935).

Thus, at least since the enactment of § 257, it has been firmly established that a reorganization court is empowered to order the turnover of proerty in the hands of a trustee or receiver incident to the enforcement of a lien. *Emil* v. *Hanley, supra*. It was also well established that the turnover provisions were not limited to property in the hands of court appointed officers having the title of "trustee" or "receiver" or "agent". Creditors in possession of the debtor's property incident to enforcement of a lien came within the meaning of "foreclosure receiver". *See Reconstruction Finance Corp.* v. *Kaplan, supra; In re Franklin Garden Apartments*, 124 F. 2d 451 (2d Cir. 1941); and *In re Third Avenue Transit Corp.*, 198 F. 2d 703 (2d Cir. 1952). This was the state of the law prior to the enactment of the new Code. Where did these broad turnover powers go when the Act was repealed and the Code went into effect?

Section 542 and 543 are the only express turnover provisions in the new Code. Since the *Avery* case has rendered the former inapplicable, the applicability of the latter must now be determined. Section 543 applies only to property in the hands of custodians and provides in part as follows:

> § 543(b) A custodian shall-
>
> (1) deliver to the trustee any property of the debtor transferred to such custodian, or proceeds of such property, that is in such custodians possession, custody or control on the date that such custodian acquires knowledge of the commencement of the cases . . .

Whether § 543 applies to the Service in a case such as ours turns on whether the Service is a custodian within the meaning of § 101(10) which provides in pertinent part:

§ 101(10) "custodian" means-

(c) trustee, receiver, or agent under applicable law, or under a contract, that is appointed or authorized to take charge of property of the debtor for the purpose of enforcing a lien against such property, or for the purpose of general administration of such property for the benefit of the debtors' creditors

For the purposes of our case the essential terms of clause (c) are these: A custodian includes an agent under applicable law authorized to take charge of property of the debtor for the purpose of enforcing a lien against such property. There is a familiar ring to this language. This definition of custodian, in one of its aspects, appears to be the latter-day description of a "foreclosure trustee". It would appear, therefore, that one type of entity subject to the turnover provision of § 543 is the same kind of entity treated as a "foreclosure trustee" in cases decided under the Act.

As has already been observed, these entitites included mortgages under a mortgage, pledgees pursuant to a factor lien agreement, trustee under a trust deed and the like. Is there any distinction worth drawing between the Service in possession of seized property and a mortgagee in possession of property under a mortgage? This Court thinks not. When the Service filed its tax lien it became, in effect, a lien creditor with respect to all of the debtor's property. By seizing the property, the Service did not change the nature of its interest from a lien interest to ownership; all it did was take another step in the process of enforcing its lien.

The United States' reliance on *Phelps* v. *United States*, 421 U.S. 370 (1975) in support of its contention that seizure is tantamount to ownership, is misplaced. All the courts that have addressed the issue at bar have distinguished *Phelps* on the ground that it only dealt with the old summary vs. plenary jurisdiction of the bankruptcy courts under the Act. But *Phelps* is inapposite for another, more important reason.

The *Phelps* court was dealing with a straight bankruptcy case, not a reorganization case. As was discussed above, property in the hands of a "foreclosure trustee" could not be the

subject of a turnover order in straight bankruptcy. In effect, the *Phelps* court held that the assignee in that case was holding the disputed funds not as a mere naked bailee for creditors generally (i.e. equity receiver) but as a custodian for the United States, a bona fide adverse claimant (i.e. "foreclosure trustee"). *Phelps* at 337. All the talk about "ownership" cropped up in the context of the courts jurisdiction, vel non, over property in the hands of, or being held for, an adverse claimant. In Chapter IV this was a crucial issue. *See generally* Collier (14th Ed.) ¶ 23.06 p 494 *et seq.* Under Chapter X, the nature of a claimant's (or debtor's) possession was rendered largely irrelevant by § 257 and other provisions of the Act that gave a reorganization court expanded jurisdiction and extra powers that were considered neither necessary nor appropriate in Chapter IV cases. *See, Emil* v. *Hanley, supra.* Therefore, any language in *Phelps* that can be construed to mean that ownership of the seized property passed from the debtor to the Service is dicta merely and is completely inapplicable to the case at bar. Once we shed all the "tantamount to ownership" talk and the related exercise of balancing the respective rights of the Service and the debtor in the seized property, what remains is this:

The Service has *custody* of the debtor's property incident to the enforcement of its lien. Certainly, the Service has a very substantial interest in the seized property, but no more so than a mortgagee foreclosing upon real property of a debtor who has a receiver appointed to take possession of the property prior to the filing of a petition. The fact that the Service itself has custody of the debtor's property and not a court-appointed officer is of no consequence. Therefore, the Service in possession of pre-petition seized property must be considered a custodian within the meaning of § 101(10)(c) and thus subject to the turnover provisions of § 543.

The only question remaining is whether this court should order the turnover of the seized property or excuse compliance pursuant to § 543(d). In deciding this question, the pre-code cases again are instructive. Under the Act, the powers given a bankruptcy court by § 257 were considered drastic powers to

be exercised only in the most "extraordinary circumstances". *In re Third Avenue Transit Corp.*, *supra* at 706; *see also RFC* v. *Kaplan*, *supra*; *In re Franklin Garden Apartments*, *supra*. In the *Third Avenue Transit* case, the Second Circuit Court of Appeals established the following guidelines for determining what was an appropriate case for a turnover order:

> 1. The use of the property must be necessary to the successful rehabilitation of the debtor,
>
> 2. The debtor can be reorganized in accordance with the Act within a reasonable period of time, and
>
> 3. The entity that is being dispossessed of its security will not be injured thereby.

If these guidelines are applied to the case at bar, it is seen that the use of the seized property is absolutely necessary to the debtor's survival. Without the use of its equipment, inventory and other items seized by the Service, surely the debtor must fold. From testimony taken at the hearings, the preliminary hearing and the final hearing, it appears that the debtor has a reasonable chance to reorganize and become a profitable business again. But a turnover of the seized property should not be ordered if the United States will be injured thereby. The debtor abused a fidicuary duty of the highest order when if failed to pay the taxes it withheld from its employees' wages and the ability of the Service to recover those taxes should not unreasonably be impaired.

It is important to note here that unlike § 542, § 543 does not expressly provide for adequate protection. Section 543(d), literally applied, would seem to permit either an unconditional turnover or maintenance of the status quo depending on which course best serves the interests of creditors. In this case, such a literal interpretation creates an intolerable dilemma. For this reason, § 542 would seem the more appropriate section for resolving the controversary at bar because it incorporates by reference the terms of § 363(e) which permits a court to condition any turnover order upon the ability of the debtor to give adequate protection. *See* Collier (15th Ed.) ¶ 363.04 at 362-23 (illustrating the treatment under the Code of the *RFC* v.

Kaplan Scenario and discussing the interrelationship of §§ 542, 363 and 362).

In any event, the ability of this Court to fashion a just remedy should not be limited by reading § 543(d) to literally. Whether the courts' turnover power is properly found in §§ 542, 543 or even § 105 (to carry out the purpose of the automatic stay as was the case in *RFC* v. *Kaplan)* the Court must have the concommitant power to require adequate protection.

Therefore, to accomplish the purposes of both the Bankruptcy and Internal Revenue Codes, the Service must release the seized property to the debtor-in-possession upon the following conditions:

1. That the debtor-in-possession pay IRS as adequate protection under 11 U.S.C. § 361 the sum of $20,000 before the turnover occurs, and

2. That the debtor shall pay to IRS the sum of $1,000 a month until the tax is paid, and

3. That during this period of time IRS shall retain its lien upon the property seized, and

4. That if the debtor fails to make the payments required when IRS turns over the property, the stay shall be lifted,

and it is so ordered.

Date: April 28, 1981

Edward D. Hayes
EDWARD D. HAYES
Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NEW YORK

CASE NO. 81-20063
81-2034A

In re

WHITING POOLS, INC.,

Debtor.

UNITED STATES OF AMERICA,

Plaintiff,

vs

WHITING POOLS, INC.,

Defendant.

ORDER

At Rochester, New York in the said District on the day of April, 1981.

In accordance with the attached Findings of Fact and Conclusions of Law, it is

ORDERED that IRS turn back the property seized to the debtor in possession, and it is further

ORDERED that the debtor in possession pay IRS as adequate protection under 11 U.S.C. § 361 the sum of $20,000 before the turnover occurs, and it is further

ORDERED that the debtor shall pay to IRS the sume of $1,000 a month until the tax is paid, and it is further

ORDERED that during this period of time IRS shall retain its lien upon the property seized, and it is further

ORDERED that if the debtor fails to make the payments required when IRS turns over the property, the stay shall be lifted.

ENTER:

Edward D. Hayes
EDWARD D. HAYES
Bankruptcy Judge

APPENDIX C

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF NEW YORK

In re
WHITING POOLS, INC.,

Debtor.

CIV-81-362B(E)

Received June 19, 1981
United States Attorney

MEMORANDUM AND ORDER

This is an appeal from an order of the Bankruptcy Court which would require the Internal Revenue Service ("the IRS") to turn over to the debtor property which the IRS had levied upon and seized. My Order filed May 6, 1981 stayed the effect of the Bankruptcy Court's order pending disposition of this appeal. For the reasons set out below, I am reversing that court's order.

The debtor, Whiting Pools, Inc., sells, installs and services swimming pools and pool equipment and supplies and maintains a place of business located in Fairport, N.Y. The IRS made an assessment of tax against the debtor for unpaid employment taxes owing for the third and fourth quarters of 1979 and the second and third quarters of 1980. Despite the IRS's demand for payment, the unpaid balance of such assessment is approximately $92,000. Pursuant to a warrant issued by the United States Magistrate, the IRS entered the debtor's place of business January 14, 1981 and levied upon and seized the debtor's inventory, equipment and other personal property. The debtor filed a petition under Chapter 11 of the Bankruptcy Code January 15, 1981. The IRS commenced an adversary proceeding for a determination by the Bankruptcy Court that the automatic stay provisions of the Bankruptcy Code, 11 U.S.C. § 362, are inapplicable to its proposed sale of the levied property. The debtor counterclaimed for an order requiring the IRS to turn over the levied property.

After an evidentiary hearing, [1] the Bankruptcy Court entered an order April 28, 1981 requiring the IRS to turn over the levied property to the debtor. The court conditioned this relief upon the debtor's payment of $20,000 to the IRS prior to turnover and $1,000 monthly thereafter. Under the terms of the court's order, the debtor's failure to make said monthly payment would automatically cause the order to be lifted.

The Bankruptcy Code contains two provisions which pertain to the turnover of property to the debtor. 11 U.S.C. §§ 542, 543. Section 542 generally requires any entity, other than a custodian, in possession of property of the estate to deliver said property to the trustee. [2] Section 543 requires a custodian to deliver to the trustee any property of the debtor that is in the custodian's possession on the date that the custodian learns of the commencement of the bankruptcy case. [3] In a recent case

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[1] The Bankruptcy Court conducted an evidentiary hearing on two separate days. Neither the IRS nor the debtor has requested that a transcript of said hearing be included in the record. Inasmuch as the underlying facts are not disputed and the issue presented herein is a legal one concerning the Bankruptcy Court's power to order a turnover of the levied property, I have not requested the preparation of a transcript.

[2] Section 542(a) provides as follows:

"* * * [A]n entity, other than a custodian, in possession, custody, or control, during the case, of property that the trustee may use, sell, or lease under section 363 of this title, * * * shall deliver to the trustee, and account for, such property or the value of such property, unless such property is of inconsequential value or benefit to the estate."

Section 363 authorizes the trustee to use, sell, or lease "property of the estate." "Property of the estate" is defined as "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a)(1).

[3] Section 543(b) states that a custodian shall:

> "deliver to the trustee any property of the debtor transferred to such custodian, or proceeds of such property, that is in such custodian's possession, custody or control on the date that such custodian acquires knowledge of the commencement of the case * * *."

arising under virtually identical circumstances as the present one, I held that the IRS may not be required under section 542 to turn over to the debtor property that had been levied upon and seized prior to the commencement of the case. *In re Avery Health Center, Inc.*, 3 C.B.C.2d 728 (W.D.N.Y. 1981). The Bankruptcy Judge recognized that *Avery Health Center, Inc.* forecloses application of section 542 to require the IRS to turn over the levied property in the present case. Nevertheless, he concluded that the IRS is a custodian of property of the debtor within the meaning of section 543 and therefore ordered the turnover of the property pursuant to that section.

The relevant definition of the term custodian is set out in section 101(10)(C) of the Bankruptcy Code, which states that "custodian" means:

> "trustee, receiver, or agent under applicable law, or under a contract, that is appointed or authorized to take charge of property of the debtor for the purpose of enforcing a lien against such property, or for the purpose of general administration of such property for the benefit of the debtor's creditors * * *."

The Bankruptcy Judge focused on the language of section 101(10)(C) indicating that a custodian is an "agent" authorized to take charge of property of the debtor for the purpose of enforcing a lien against such property. [4]

Although the Bankruptcy Code does not contain a definition of the term "agent," the concept of agency entails a fiduciary relationship arising out of an express or implied contract between the principal and the agent. Thus, it has been held that a secured creditor in possession of property taken from a debtor pursuant to the terms of a security agreement is an agent and therefore a custodian within the meaning of section 101(10)(C). *Matter of Williams*, 3 C.B.C.2d 84 (B.Ct. E.D. Mich. 1980). In

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[4] There has been no contention on this appeal that the IRS is a "trustee" or a "receiver" as those terms are used to define a custodian.

the present case, however, there is no contractual understanding between the IRS and the debtor from which an agency relationship may be said to have arisen. [5]

Section 101(10)(C) also indicates that a custodian may be an "agent under applicable law * * *." The provisions of the Internal Revenue Code which authorize the IRS to levy upon and seize a taxpayer's property, 26 U.S.C. § 6331, do not purport to create an agency relationship. Rather, the IRS given the authority to sell the levied property subject to few restrictions. [6]

A levy by the IRS "is substantially broader in scope than anything known to the common law * * *." *United States* v. *Sullivan*, 333 F.2d 100, 116 (3d Cir. 1964). Thus, courts have indicated that a tax levy "is 'an absolute appropriation in law,' and a seizure of the property levied upon, tantamount to a

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[5] The Bankruptcy Judge noted that under the Bankruptcy Act of 1898 a mortgagee, pledgee or trustee under a trust deed could be ordered to turn over property of the debtor in a reorganization proceeding. *See, e.g., In re Third Ave Transit Corp.*, 198 F.2d 703 (2d Cir. 1952); *Reconstruction Finance Corp.* v. *Kaplan*, 185 F.2d 791 (1st Cir. 1950); *In re Franklin Garden Apartments*, 124 F.2d 451 (2d Cir. 1941). Finding no reason to distinguish between such persons and the IRS, the Bankruptcy Judge concluded that section 543 must apply to property upon which the IRS has levied. However, the existence of a contract giving rise to an agency relationship is a crucial distinction between the cases cited by the Bankruptcy Judge and the present case.

[6] After levy upon and seizure of the property, the IRS may sell the property upon the following conditions: (1) the proceeds of the sale must be applied toward payment of the underlying tax liability, (2) any surplus remaining after payment of the tax liability and the expenses of sale must be returned to the taxpayer (or other lien creditors), and (3) the taxpayer may redeem the property prior to sale by tendering payment of the tax liability. 26 U.S.C. §§ 6337, 6342. The Internal Revenue Code also prescribes certain procedures to be used in connection with the sale. 26 U.S.C. § 6335.

transfer of ownership." *United States* v. *Pittman*, 449 F.2d 623, 626 (7th Cir. 1971). *See, also, Phelps* v. *United States*, 421 U.S. 330, 337, n.8 (1975) ("the prebankruptcy levy displaced any title of [the debtor]"); *Matter of Pittsburgh Penguins Partners*, 598 F.2d 1299, 1302 (3d Cir. 1979); *Am. Acceptance Corp.* v. *Glendora Better Builders*, 550 F.2d 1220, 1222-3 (9th Cir. 1977) (upon levy and seizure of the property, "all rights were held by the IRS"); *United States* v. *Sullivan*, *supra*, at 116 (a levy "effects a seizure of the delinquent's property tantamount to a transferal of ownership"); *Matter of Chantler Baking Co.*, 436 F.Supp. 169, 174 (W.D.Pa. 1977) ("a tax levy operated to endow IRS with *all* rights in the seized property"). These cases make clear that the IRS, after levying upon and seizing a taxpayer's property, is not a mere "agent" or "custodian" of the property. I accordingly hold that the IRS is not a custodian subject to the turnover provisions of Bankruptcy Code § 543.

The Bankruptcy Court's order which would require the IRS to turn over the levied property to the debtor is hereby ORDERED reversed. The case is remanded to the Bankruptcy Court for a determination whether the stay of the IRS's proposed sale of the levied property imposed by Bankruptcy Code § 362 should be terminated. [7] The Bankruptcy Court

---

[7] The Bankruptcy Court held that the automatic stay provisions of section 362 apply to the IRS's proposed sale of the levied property. The IRS has not appealed from that aspect of the court's decision.

The IRS seeks to be released from the stay "for cause" under Bankruptcy Code § 362(d)(1). As the Bankruptcy Court previously noted, "it makes little sense to continue the stay unless a turnover of property can accompany the stay."

shall also reconsider, in light of this decision, its order dated April 30, 1981 directing Banker's Trust Company to pay certain levied funds to the IRS and further directing that such funds be considered as partial payment of the $20,000 which the debtor was required to pay to the IRS.

Dated: Buffalo, N.Y.
June 16, 1981

/s/ John T. Elfin
JOHN T. ELFIN
U.S.D.J.

APPENDIX D

STATUTES

11 U.S.C. (Supp. IV) (Bankruptcy Code):

§ 363. *Use, sale, or lease of property*

* * * * *

(b) The trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate.

* * * * *

(d) The trustee may use, sell, or lease property under subsection (b) or (c) of this section only to the extent not inconsistent with any relief granted under section 362(c), 362(d), 362(e), or 362(f) of this title.

(e) Notwithstanding any other provision of this section, at any time, on request of an entity that this has an interest in property used, sold, or leased, or proposed to be used, sold, or leased, by the trustee, the court shall prohibit or condition such use, sale, or lease as is necessary to provide adequate protection of such interest. In any hearing under this section, the trustee has the burden of proof on the issue of adequate protection.

* * * * *

§ 541. *Property of the estate*

(a) The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised of all the following property, whereever located:

(1) Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case.

(2) All interests of the debtor and the debtor's spouse in community property as of the commencement of the case that is—

(A) under the sole, equal, or joint management and control of the debtor; or

(B) liable for an allowable claim against the debtor or for both an allowable claim against the debtor and an allowable claim against the debtor's spouse, to the extent that such interest is so liable.

(3) Any interest in property that the trustee recovers under section 543, 550, 553, or 723 of this title.

(4) Any interest in property preserved for the benefit of or ordered transferred to the estate under section 510(c) or 551 of this title.

(5) An interest in property that would have been property of the estate if such interest had been an interest of the debtor on the date of the filing of the petition, and that the debtor acquires or becomes entitled to acquire within 180 days after such date ——

(A) by bequest, devise, or inheritance;

(B) as a result of a property settlement agreement with the debtor's spouse, or of an interlocutory or final divorce decree; or

(C) as a beneficiary of a life insurance policy or of a death benefit plan.

(6) Proceeds, product, offspring, rents, and profits of or from property of the estate, except such as are earnings from services performed by an individual debtor after the commencement of the case.

(7) Any interest in property that the estate acquires after the commencement of the case.

(b) Property of the estate does not include any power that the debtor may only exercise solely for the benefit of an entity other than the debtor.

* * * * *

(d) Property in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest, such as a mortgage secured by real property, or an interest in such a mortgage, sold by the debtor but as to which the debtor retains legal title to service or supervise the servicing of such mortage or interest, becomes property of the estate under subsection (a) of this section only to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold.

* * * * *

§ 542. Turnover of property to the estate

(a) Except as provided in subsection (c) or (d) of this section, an entity, other than a custodian, in possession, custody, or control, during the case, of property that the trustee may use, sell, or lease under section 363 of this title, or that the debtor may exempt under section 552 of this title, shall deliver to the trustee, and account for, such property or the value of such property, unless such property is of inconsequential value or benefit to the estate.

* * * * *

Internal Revenue Code of 1954 (26 U.S.C.):

§ 6331. *LEVY AND DISTRAINT.*

(a) [as amended by Section 1906(b)(13)(A), Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520]. *Authority of Secretary.*—If any person liable to pay any tax neglects or refuses to pay the same within 10 days after notice and demand, it shall be lawful for the Secretary to collect such tax (and such further sum as shall be sufficient to cover the expenses of the levy) by levy upon all property and rights to property (except such property as is exempt under section 6334) belonging to such person or on which there is a lien provided in this chapter for the payment of such tax. Levy may be made upon the accrued salary or wages of any officer, employee, or elected official, of the United States, the District of Columbia, or any agency of instrumentality of the United States or the District of Columbia, by serving a notice of levy on the employer (as defined in section 3401(d)) of such officer, employee, or elected official. If the Secretary makes a finding that the

collection of such tax is in jeopardy, notice and demand for immediate payment of such tax may be made by the Secretary and, upon failure or refusal to pay such tax, collection thereof by levy shall be lawful without regard to the 10-day period provided in this section.

* * * * *

(b) [as amended by Section 104(a), Federal Tax Lien Act of 1966, Pub. L. No. 89-719, 80 Stat. 1125 and Section 1209(d), Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1710] *Seizure and Sale of Property.*—The term "levy" as used in this title includes the power of distraint and seizure by any means. Except as otherwise provided in subsection (d)(3), a levy shall extend only to property possessed and obligations existing at the time thereof. In any case in which the Secretary or his delegate may levy upon property or rights to property, he may seize and sell such property or rights to property (whether real or personal, tangible or intangible).

* * * * *

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In The

Supreme Court of the United States

OCTOBER TERM, 1982

UNITED STATES OF AMERICA,

Petitioner,

v.

WHITING POOLS, INC.,

Respondent.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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In The

Supreme Court of the United States

OCTOBER TERM, 1982

UNITED STATES OF AMERICA,

Petitioner,

v.

WHITING POOLS, INC.,

Respondent.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

STATEMENT OF CASE

Petitioner's statement of the case is substantially accurate, though it makes some omissions which we wish to note for the Court.

In ordering the turnover at issue, the Bankruptcy Court below made several findings of fact that are not controverted, to wit:

1. Whiting's indebtedness to the IRS for unpaid employment taxes is approximately $92,000.00;

2. The seized assets have a going concern value of $162,876.00;

3. Other than the IRS tax lien, the only existing lien against the seized assets was a security interest owned by Marine Midland Bank in the amount of either $6,000.00 or $12,500.00.

4. Based on the above, the debtor has a substantial equity in the seized property.

5. Public sale of those assets by the IRS will yield a *maximum* of $30,000.00 — $35,000.00.

(App. B to Petition, 35a-36a). The Bankruptcy Court concluded, based on these findings, that "the seized property is absolutely necessary to an effective reorganization of the debtor" since "the debtor will cease to exist" once the sale occurs. (App. B to Petition, 36a). Accordingly, the Bankruptcy Court determined that turnover is in the best interest of the government, since the IRS would recover more on its tax claim from a successfully reorganized business than from a tax sale, and its interest could be adequately protected in the interim. These factual conclusions have not been disputed by the government.

SUMMARY OF ARGUMENT

The petition should be dismissed, or, in the alternative, the petition should be granted and the decision of the court of appeals affirmed summarily, for the following reasons:

1. Certiorari should be denied because the decision of the court below, while inconsistent with the decision of the Fourth Circuit in *Cross Electric Co. v. United States*, 664 F.2d 1218, (4th Cir. 1981), is not squarely in conflict therewith. The debtor in the case at bar, unlike the debtor in *Cross Electric*, has a substantial equity in tangible assets that can be used by the reorganized debtor while the interests of the government are adequately protected.

2. The construction placed on section 542(a) of the Bankruptcy Code by the court of appeals is supported by a clearly expressed legislative intent to encourage successful rehabilitation of business debtors. The literal construction urged by the government would have a disastrous impact on business reorganizations that could not have been intended by Congress since it is contrary to the purposes and policies of the Bankruptcy Code.

3. The plain meaning rule is inapplicable because the relevant statutes are ambiguous on their face. The literal, mechanical construction urged by the government yields an absurd result that could not have been intended by Congress. Thus, the court of appeals was justified in construing section 542(a) in accordance with the settled law of reorganizations, the policies of the Bankruptcy Code and the circumstances of its enactment.

4. Property seized in a pre-petition tax levy is subject to turnover since the language of section 542(a) of the Bankruptcy Code makes no distinction between the Internal Revenue Service and other creditors. Cases holding that the bankruptcy court lacked summary jurisdiction over such property in liquidating bankruptcies and Chapter XI proceedings under the Bankruptcy Act are inapposite. The new Bankruptcy Code contains both an express grant of turnover authority and expanded jurisdictional provisions that render the prior law irrelevant.

REASONS FOR DENYING THE PETITION

1. The principal reason cited by the government for this Court to grant its petition is its allegation that the decision of the court of appeals below squarely conflicts with the decision of the Fourth Circuit in *Cross Electric Co. v. United States*, 664 F.2d 1218 (4th Cir. 1981). This perceived conflict, however, is more apparent than real. Although in its decision below the Second Circuit stated that it was reaching "an opposite result" from the Fourth Circuit (App. A. to Petition, 2a), in actuality the underlying facts differ so substantially between the present case and *Cross Electric* as to make the two court of appeals decisions at most inconsistent, but certainly not opposite.

In *Cross Electric* the Fourth Circuit denied the turnover to the Debtor-In-Possession of an account receivable which had been levied upon by the IRS pre-petition. The outstanding tax indebtedness was more than seven times greater than the account seized. Therefore, the debtor had no equity in the seized assets. Nor could the debtor use, sell or lease the asset without actually consuming it. Relying on its earlier decision in *United States v. Eiland*, 223 F.2d 118 (4th Cir. 1955), the Fourth Circuit considered the pre-petition levy on an account receivable to be a "virtual transfer" of the indebtedness of the government.

In the present case, however, the property levied upon is principally equipment and inventory. The IRS would be required to go through extensive sale and public notice procedures in order to realize upon the assets. Under the relevant provision of the Internal Revenue Code, the debtor would retain various rights as the "owner" of the seized property until after the sale.[1] Also, as the bankruptcy court below found, the present debtor has substantial equity in the

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[1] Internal Revenue Code of 1954 §6337; 26 U.S.C. §6337.

seized assets, has a good prospect of being rehabilitated, needs the seized assets in order to do so, and the Internal Revenue Service can be adequately protected if a turnover is ordered.

The very lack of substantial conflict between the Fourth Circuit and Second Circuit decisions is manifested by the courts' respective definitions of the points at issue in the two cases. In *Cross Electric,* the court wrote that:

> "This case presents the issue whether *an account receivable,* levied upon by the Internal Revenue Service (hereinafter "IRS") prior to the date on which a debtor files a petition for reorganization, is "property of the estate" within the meaning of 11 U.S.C. §541 and thus subject to administration in the bankruptcy proceedings. We hold that, *under the facts of this case,* it is not".

Cross Electric Co. v. United States, supra, p. 1219. (emphasis supplied). Contrast this with the following statement by the Court below:

> The question on this appeal is whether a debtor in possession under Chapter 11 of the Bankruptcy Code of 1978 is entitled to an order, under §§542 or 543 of the Code, requiring the Internal Revenue Service (IRS) to turn over *tangible assets* of the debtor on which the IRS had levied pursuant to §6331 *et seq.* of the Internal Revenue Code (IRC).

United States v. Whiting Pools (App. A. to Petition, 2a) (emphasis supplied).

As the two courts of appeals did not purport to decide the same issue, it is difficult to conclude that the decisions of the courts squarely conflict as urged by the government. Accordingly, it is not necessary for this Court to grant the government's petition in order to resolve an alleged conflict between the circuits.

This absence of a conflict "on all fours", however, does not mean that the issue in this case is not a critical one in the

uniform administration of the bankruptcy laws throughout the country. It is respectfully submitted that, should this Court agree with the Second Circuit that, under appropriate factual circumstances, a bankruptcy court may order the Internal Revenue Service to turnover to a debtor-in-possession tangible assets which it had seized prior to a Chapter 11 petition, appropriate national uniformity could be achieved by a denial of the government's present petition or, preferably, by a summary affirmance of the decision below.

2. The government contends that the decision below is contrary to the plain meaning of the relevant statutory provisions and Congress' intent in enacting the new Bankruptcy Code. However, in our view, the court of appeals was correct in rejecting the overliteral, formalistic construction of the Bankruptcy Code urged by the government, in favor of a construction consistent with the purposes and policies of the statute as expressed in the legislative history. In construing the predecessors to the Bankruptcy Code, the Courts have traditionally eschewed "narrow formalistic interpretations which disregard the spirit and letter of the [statute]" (*Wright v. Union Central Life Insurance Co.*, 311 U.S. 273, 278 [1940]) and sought a construction which effectuates the general purpose and policy of the bankruptcy statute. See, e.g., *Lines v. Frederick*, 400 U.S. 18, 19-20 [1970]; *Segal v. Rochelle*, 382 U.S. 375, 379 [1966]; *Wright v. Union Central Life Insurance Co. supra*, p. 279; *Local Loan Co. v. Hunt*, 292 U.S. 234, 244-45 [1934]; *Maynard v. Elliott*, 283 U.S. 273, 277 [1930]. Although no reason appears for abandoning this approach in construing the language of the Bankruptcy Code, the government ignores the purposes and policies of the Code and argues in favor of an ahistorical and mechanical interpretation of the provisions relating to the turnover power of the Bankruptcy Court.

Under the government's construction of section 542(a) of the Bankruptcy Code,[2] the turnover obligation of a creditor in possession of the debtor's property is limited to a requirement that the creditor deliver to the trustee in bankruptcy all the debtor's *interests in the property* existent on the date the bankruptcy petition was filed. If this interpretation were correct, then the bankruptcy court would lack the power, even in a reorganization case, to displace a secured creditor in possession of property in which the debtor has an interest.[3] It follows that a creditor who, to recover an indebtedness totalling $1,000, obtains execution upon tangible property such as machinery or inventory worth $100,000 (and thereby precipitates the filing of a Chapter 11 petition) could not be compelled to surrender possession of that machinery or inventory to a reorganization trustee or debtor-in-possession regardless of the impact on the reorganization debtor's ability to continue in business or of the availability of "adequate protection" under sections 363(e) and 361 of the Bankruptcy Code. This curious construction of the statutory scheme would render §542(a) superfluous, except as a means of obtaining turnover from persons in wrongful possession of the debtor's property. More importantly, such a construction is in irreconcilable conflict with a clearly expressed legislative policy in favor of promoting successful business reorganizations.

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[2]Section 542(a) provides, in relevant part, that:

> "an entity . . . in possession, custody, or control, during the case, of property that the trustee may use, sell or lease under section 363 of this title, or that the debtor may exempt under section 522 of this title, shall deliver to the trustee, and account for, such property or the value of such property unless such property is of inconsequential value or benefit to the estate"

[3]The rule of *Cross Electric Co. v. United States*, 664 F.2d 1218, *supra*, has already been applied outside the context of a tax levy. See, *In re Campbell*, 20 B.R. 42 (Bankr. Ct. D.S.C. 1982). In *Campbell*, the bankruptcy judge held that an automobile repossessed by a secured creditor but not sold prior to the commencement of the case was not subject to turnover under section 542(a).

The House Committee Report accompanying H.R. 8200 states that the purpose of the business reorganization under the Code "is to restructure a business's finances so that it may continue to operate, provide its employees with jobs, pay its creditors, and produce a return for its stockholders" (H.R. Rep No. 95-595, 95th Cong., 1st Sess, 220, *reprinted in* 1978 U.S. Code, Cong. & Admin. News, 5963, 6179). Based upon the premise that assets used in an ongoing business are generally more valuable than those same assets when liquidated, the House Report made a legislative finding that "[i]t is more economically efficient to reorganize than to liquidate, because it preserves jobs and assets". H.R. Rep. No. 95-595, *supra*, at 220. The comments of the House sponsors of H.R. 8200 during floor debates are in the same vein; indicating a Congressional preference for business reorganizations over liquidations and a Congressional intent to encourage reorganization by incorporating the *combined* reorganization powers available under Chapters X, XI and XII of the Bankruptcy Act into a single reorganization Chapter under the Code.[4]

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[4]During the House debate on the Compromise bill, Representative Edwards, a House sponsor, stated that:

> "The amendment also encourages business reorganizations by a streamlined new commercial reorganization Chapter . . . It will protect the investing public, protect jobs, and help save troubled businesses".

(124 Cong. Rec. H 11089 [daily ed. Sept. 28, 1978]).

In debates prior to the initial passage of H.R. 8200, Representative Edwards explained the reasons for consolidation of the three reorganization chapters of the Bankruptcy Act of 1898 into a single Chapter 11 under the Bankruptcy Code:

> "Now for businesses, we make it easier for them to repay their creditors, too . . . [N]one of the three chapters offers the full scope of bankruptcy powers that a business could use to reorganize and repay its creditors rather than going into straight bankruptcy under which creditors usually get very little . . .
>
> We consolidate the three reorganization chapters into one flexible chapter. *It gives the debtors the combined powers of the three current chapters, and gives creditors the combined protection of the three chapters* . . . This way creditors get more than if the business went into straight liquidation.
>
> It also will save more businesses, which will protect jobs and protect public and private investors".

(123 Cong. Rec. H 11699 [daily ed. October 27, 1977] [emphasis added]).

Footnote continued on next page—

The government's reading of the statutory scheme conflicts with the Congressional intent to foster business reorganizations by placing property in the possession of a secured or executing creditor beyond the reach of the turnover power of the bankruptcy court. Obviously, the loss of tangible property to a particular secured creditor will diminish the chances that the debtor's business can continue to function. See, 6 *Collier on Bankruptcy*, ¶3.05, p. 431 (14th ed 1977). Where, as in the case at bar, the creditor is in possession of all the tangible assets of the debtor, the inevitable result will be business failure and immediate liquidation — to the detriment of the debtor, its creditors, its shareholders, and its employees.

In contrast, the construction placed upon the statute by the court of appeals is in harmony with the congressional policy favoring business reorganizations. A broad turnover power — under which third parties must surrender possession of all property in which the debtor has a legal or equitable interest — enables the debtor to use all of its assets in its attempt to continue in business. The interest of the secured or executing creditor in the debtor's property is preserved by the requirement of section 363(e) of the Bankruptcy Code[5] that the court be assured that there is "adequate protection" of each

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—Footnote continued from preceding page

During these same debates, Representative Rodino, Chairman of the House Judiciary Committee, observed that "[f]or businesses, the bill facilitates reorganizations, protecting investments, and jobs". (123 Cong. Rec. H 11697 [daily ed. October 27, 1977]).

[5]Section 363(e) provides, in relevant part that:

> "on request of an entity that has an interest in property used, sold, or leased, or proposed to be used, sold, or leased, by the trustee, the Court shall prohibit or condition such use, sale, or lease as is necessary to provide adequate protection of such interest. . . ."

Section 361 of the Bankruptcy Code describes the means by which the Bankruptcy Court may provide adequate protection.

creditor's interest. As Congress intended, all concerned — the debtor as well as its creditors, shareholders and employees — benefit from the improved prospects for a successful reorganization.

3. The legislative history supports the Court of Appeals' construction of the relevant statutory provisions.

In construing any federal statute, the starting point must, of course, be the language employed by the Congress. E.g. *Reitman v. Sonotone Corp.*, 442 U.S. 330, 337 [1979]. Under the "plain meaning" rule of statutory construction, where the language is clear it must ordinarily be regarded as conclusive, absent a clearly expressed legislative intent to the contrary. E.g., *American Tobacco Co. v. Patterson*, ____ U.S. ____, 102 S.Ct. 1534, 1537 [1982]; *Consumer Product Safety Commission v. GTE Sylvania, Inc.*, 447 U.S. 102, 108 [1980]. But the plain meaning rule is "rather an axiom of experience than a rule of law", *Boston Sand Co. v. United States*, 278 U.S. 41, 48 [1928], and, as such, does not bar a Court from looking beyond the apparent meaning of the words of a statute upon superficial examination to consideration of the circumstances of the particular enactment. *Watt v. Alaska*, 451 U.S. 259, 266 [1981]; *Train v. Colorado Public Interest Research Group*, 426 U.S. 1,10 [1976]; *United States v. American Trucking Assns., Inc.*, 310 U.S. 534, 543-44 [1940].

Despite the assertions of the government to the contrary, the Court below did not violate the plain meaning rule by discerning the legislative intent from an analysis of the legislative history of the Bankruptcy Code. Upon careful examination, the statutory language contains an inherent ambiguity that cannot be resolved without reference to the legislative history.

Section 542(a) is silent on the critical question of whether turnover is required of all property in which the debtor has an interest or merely of all property interests of the debtor as of

the filing of a bankruptcy petition. The government reaches the latter result by reasoning that "property that the trustee may use, sell or lease under section 363 of this title" (11 U.S.C. §542[a]) is, by definition, "property of the estate" (11 U.S.C. §363[b], [c][1]), and that section 541(a) of the Bankruptcy Code, in turn, defines "property of the estate"[6] as including "all legal or equitable interests of the debtor in property as of the commencement of the case" (Petition pp 7-8). If the government's reasoning is correct, then section 542(a) literally requires an entity "in possession, custody or control" of the debtor's legal or equitable interests in property to "deliver" those interests to the trustee. But what possible meaning can be given to the words "possession, custody or control" when they are applied to an "interest" in property owned by the debtor, particularly to an equitable interest? The government's literal reading of section 542(a) yields an absurd result. No entity could have "possession" of an equitable interest owned by the debtor and no entity could "deliver" such an interest to the trustee. It is apparent from the use of the words "possession, custody and control" and "deliver" that the drafters of section 542(a) contemplated that the turnover power would be applied to *property* held by a third party in which the debtor has some legal or equitable property interest, rather than to the interest itself.[7] Where the literal import of the words of a statute leads

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[6]The phrase "Property of the estate" is not actually defined in section 541(a), although it is employed as the section heading. Section 541(a) merely enumerates the forms of property comprising the bankruptcy estate.

[7]Support for this construction can also be found in the House and Senate Reports, which, in describing the purpose of §542, state that:

> "Subsection (a) of this section requires anyone *holding property of the estate* on the date of the filing of the petition, or property that the trustee may use, sell or lease under section 363, to deliver it to the trustee". H.R. Rep No. 95-595, *supra*, at 369; S. Rep. No. 95-989, 95th Cong., 2d Sess., 84 [1978], *reprinted in* 1978 U.S. Code Cong. & Admin. News 5787, 5870.

to absurd results, the Court must look to other indicia of legislative intent in construing the statute. See, *United States v. Bryan*, 339 U.S. 323, 338 [1950]; *United States v. Kirby*, 74 U.S. [7 Wall.] 482, 486 [1869]; 2A C. Sands, *Sutherland on Statutes and Statutory Construction*, §46.07, p. 65 (4th ed 1973).

In its analysis of the legislative history, the Court below found support of a broad turnover power implicit in the clearly expressed legislative intent to encourage business reorganizations, coupled with the fact that section 542 was added to the proposed bankruptcy legislation following legislative hearings in which several witnesses recommended that the turnover power available in reorganization proceedings under Chapters X and XII of the existing Bankruptcy Act be expressly incorporated into the new statute. *(United States v. Whiting Pools*, App. A. to petition, 17a-23a). In so doing, the Second Circuit considered the House Committee Report, but concluded that it contained language inconsistent with the government's narrow reading of the phrase "property of the estate" *(United States v. Whiting Pools*, App. A. to Petition 12a-13a, n.10). Having found the committee report ambiguous at best, the court of appeals was justified in looking to the congressional hearings for guidance, see, e.g., *Dawson Chemical Co. v. Rohm & Haas Co.*, 448 U.S. 176, 202-215 [1979], and in giving

> "consideration [to] the way in which Congress arrived at the statutory language [rather] than . . . trying to reconcile or establish preferences between the conflicting interpretations of the Act by individual legislators or the committee reports"

Corning Glass Works v. Brennan, 417 U.S. 188, 198 [1974].

Nevertheless, the government contends that the court of appeals erred by failing to give proper weight to statements in

the committee reports to the effect that section 541(a)(1)"is not intended to expand the debtor's rights against others more than they exist at the commencement of the case" (H.R. Rep. No. 95-595, supra, at 367; S. Rep. No. 95-989, supra, at 82) and to statements by the sponsors in debate to the effect that property becomes "property of the estate" under §541(a)(1) only to the extent of the debtor's interest in that property. (124 Cong. Rec. 32399, 33999 [1978]). These statements are not entitled to the controlling weight urged by the government because they relate to the composition of the bankrupt estate under section 541(a)(1) rather than to the turnover power under section 542(a) of the Bankruptcy Code.

Admittedly, section 541(a)(1) was not intended to expand the debtor's *rights* against third parties beyond those existing at the commencement of the case, but that is not to say that section 542(a) cannot alter the *remedies* available to the debtor. The cases have long distinguished between the deprivation of property *rights* of secured creditors by the bankruptcy courts, which would be unconstitutional, and the suspension of *remedies*, which is not. See, *Wright v. Union Central Life Ins. Co.*, 311 U.S. 273, *supra; Continental Illinois National Bank & Trust Co. v. Chicago, R.I. & P.Ry Co.*, 294 U.S. 648, 680-681 [1935]. Turnover pursuant to section 542(a) does not destroy the lien of the secured or executing creditor or deprive that creditor of its right to the value of the collateral up to the amount of the lien, since section 363(e) of the Bankruptcy Code imposes a mandatory requirement that the Court provide "adequate protection" of the creditor's rights. See generally, 2 *Collier on Bankruptcy* ¶363.06 (15th ed. 1982). Section 542(a) thus affects the remedies of the debtor without altering the debtor's or the creditor's rights.

Similarly, the scope of the turnover power under section 542(a) is not necessarily limited by a congressional intent that

the bankruptcy estate, by operation of section 541(a)(1), obtain no greater interest in property than the debtor had at the time the bankruptcy petition was filed. Both the House and Senate Reports stated that §541(a)(1) includes, as "property of the estate":

> property recovered by the trustee under section 542 of proposed Title 11, if the property received was merely out of the possession of the debtor, yet remained property of the debtor, (H.R. Rep. No. 95-595, *supra*, at 367; S. Rep. No. 95-989, *supra*, at 82).

Thus, the committee reports distinguish between possessary interests and other interests in property, and provide support for the proposition that while the bankruptcy trustee cannot obtain greater *ownership* interests than the debtor himself had, the trustee can obtain *possession* of property in which the debtor had an interest by exercising the turnover power.

Given the ambiguities in the statutory language and the legislative history, the court of appeals properly resorted to a broader consideration of legislative policy. See, *Brooklyn Savings Bank v. O'Neil*, 324 U.S. 697, 705-06 [1945]. Given the presumption that Congress is aware of the judicial construction of existing law, see, *Cannon v. University of Chicago*, 441 U.S. 677, 698-99 [1979]; *Shapiro v. United States*, 335 U.S. 1, 16 [1948], the court of appeals properly reasoned that Congress would not seek to reverse the leading reorganization case, *Reconstruction Finance Corporation v. Kaplan*, 185 F.2d 791 [1st Cir. 1950], without an explicit statement of Congressional intent. Given that the literal construction urged by the government yields an absurd result that is contrary to a clearly expressed legislative policy in favor of successful rehabilitation of business debtors, the court of appeals properly rejected that approach in favor of a construction in harmony with the purposes of the Bankruptcy Code.

4. The court of appeals correctly ruled that the turnover authority under section 542 of the Bankruptcy Code extends to tangible property seized in a pre-petition tax levy. The language of section 542 makes no differentiation between the Internal Revenue Service and other secured creditors subject to the turnover requirement.[8] Every "entity" in possession of the debtor's property must deliver it to the trustee. The government claims an entitlement to preferred treatment based upon case law decided under the former Bankruptcy Act, specifically *Phelps v. United States*, 421 U.S. 330, 335-336 [1975], and *In re Pittsburgh Penguins Partners*, 598 F.2d 1299 [3rd Cir. 1979], and the absence of a clear expression in the legislative history of the Bankruptcy Code of an intent to change the prior law.

Phelps and its progeny are irrelevant to the case at bar. *Phelps* stands for the proposition that, under the Bankruptcy Act of 1898, the bankruptcy court, in a liquidating bankruptcy, lacks summary jurisdiction over cash assets levied upon by the IRS because those assets are in the constructive possession of the IRS, an adverse claimant. 421 U.S. 330, 333-336, *supra*. In *Pittsburgh Penguins*, the Third Circuit applied the *Phelps* rationale and held that the adverse claim of the IRS deprives a Chapter XI court of summary jurisdiction over property seized by a pre-petition tax levy 598 F.2d 1299, 1302, *supra*. Unlike the case at bar, neither *Phelps* nor *Pittsburgh Penguins* involved a specific legislative grant of turnover authority to the bankruptcy court. Rather, both cases held the bankruptcy courts' extremely limited summary jurisdiction in liquidating and Chapter XI cases to be controlling. Had the IRS challenged the turnover power of the bankruptcy court in a Chapter X or Chapter XII proceeding, where section 257 or section 507 of the

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[8]Nor is there a discernible distinction between the status of a secured creditor holding repossessed collateral and that of the IRS holding seized property following a tax levy (Compare 26 U.S.C. §§6331-6344 with UCC 9-501 to 9-507).

Bankruptcy Act respectively provided just such an express grant of turnover authority,[9] a novel issue would have been raised as to whether, in a tax levy context, the turnover provision applied.[10] *Phelps* and *Pittsburgh Penguins* would not have been controlling in such a case, and thus cannot be deemed authority for the proposition that property seized in a tax levy is immune from the turnover power of the bankruptcy court where there is an express congressional grant of turnover authority, such as that provided in §542(a) of the Bankruptcy Code.

In enacting the Bankruptcy Reform Act of 1978, Congress not only superseded the relevance of *Phelps* and *Pittsburgh Penguins* by the express turnover provisions of 11 U.S.C.

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[9]Section 257 of the Bankruptcy Act (Act of July 1, 1898, ch. 541, §257, as added, Act of June 22, 1938, ch. 575 §1, 52 Stat 902; 11 U.S.C. 657) provided:

> "A trustee appointed under this chapter, upon his qualification, or if a debtor is continued in possession, the debtor, shall become vested with the rights, if any, of such prior receiver or trustee in such property and with the right to the immediate possession thereof. The trustee or debtor in possession shall also have the right to immediate possession of all property of the debtor in the possession of a trustee under a trust deed or a mortgagee under a mortgage".

Section 507 of the Bankruptcy Act (Act of July 1, 1898, ch. 541, §507, as added, Act of June 22, 1938, ch 575 §1, 52 Stat 927; 11 U.S.C. 907) provided:

> "Such prior proceeding shall be stayed by the filing of a petition under this chapter. The trustee appointed under this chapter, upon his qualification, or, if a debtor is continued in possession, the debtor, shall become vested with the rights, if any, of such prior receiver or trustee in such property and with the right to the immediate possession thereof. The trustee of debtor in possession shall also have the right to immediate possession of all real property and chattels real of the debtor in the possession of a trustee under a trust deed or a mortgagee under a mortgage".

[10]This precise question is unresolved, since no cases appear in which the IRS challenged the Courts turnover power in either a Chapter X or Chapter XII proceeding under the Bankruptcy Act.

§542(a) but also by granting the bankruptcy court exclusive jurisdiction over the debtors' property wherever located, under 28 U.S.C. §1471(e),[11] wherein jurisdiction no longer turns solely upon actual or constructive possession of the *res* or the consent of an adverse party. See, 1 *Collier on Bankruptcy* ¶¶3.01 [e]; 3.01 [g] (15th ed 1982); S. Rep. No. 95-989, *supra*, at 153; H.R. Rep. No. 95-595, *supra*, at 48-52; 445.

As both *Phelps* and *Pittsburgh Penguins* are premised upon these discarded jurisdictional distinctions, the court below was justified in disregarding those decisions. The court of appeals did not, as the government contends, change prior law — rather, it resolved a novel issue that had not been addressed in cases decided under the Bankruptcy Act.

CONCLUSION

The petition for a writ of certiorari should be dismissed; or, in the alternative, that the writ should be granted and the decision of the Second Circuit affirmed summarily on the opinion below.

Respectfully submitted,

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[11] 28 U.S.C. 1471(e) provides as follows:

"The bankruptcy court in which a case under Title 11 is commenced shall have the exclusive jurisdiction of all of the property, wherever located, of the debtor, as of the commencement of such case".

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No. 82-215

In the Supreme Court of the United States

OCTOBER TERM, 1982

UNITED STATES OF AMERICA, PETITIONER

v.

WHITING POOLS, INC.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES

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QUESTION PRESENTED

Whether a bankruptcy court in a reorganization proceeding under Chapter 11 of the Bankruptcy Code may compel the government, pursuant to 11 U.S.C. (Supp. IV) 542(a), to turn over to the debtor-in-possession property which the government had seized by levy to satisfy the debtor's delinquent federal tax liabilities prior to the filing of the bankruptcy petition.

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In the Supreme Court of the United States

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No. 82-215

UNITED STATES OF AMERICA, PETITIONER

v.

WHITING POOLS, INC.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-32a) is reported at 674 F.2d 144. The opinions of the district court (Pet. App. 46a-51a) and the order, memorandum and decision of the bankruptcy court (Pet. App. 33a-45a) are not officially reported.

JURISDICTION

The judgment of the court of appeals was entered on March 9, 1982. By orders dated May 28 and June 28, 1982, Justice Marshall extended the time for filing a petition for a writ of certiorari to and including August 6, 1982, and the petition was filed on that date. The petition was granted on November 29, 1982. The jurisdiction of this Court rests on 28 U.S.C. 1254(a).

STATUTES INVOLVED

Sections 363, 541, and 542 of the Bankruptcy Code (11 U.S.C. (Supp. IV)) and Section 6331 of the Internal Revenue Code of 1954 (26 U.S.C.) are set forth in Pet. App. 52a-56a.

STATEMENT

Respondent is a corporation which was engaged in the business of installing and servicing swimming pools and selling related supplies. During 1979 and 1980, the Internal Revenue Service made several assessments against respondent for unpaid withholding and social security taxes, which respondent concededly owed in the amount of approximately $92,000, plus interest. On January 14, 1981, in order to obtain payment of respondent's delinquent tax liabilities, the Internal Revenue Service exercised its right to levy upon property belonging to respondent, pursuant to Section 6331 of the Internal Revenue Code of 1954 (26 U.S.C.). After entering respondent's place of business, under the authority of a warrant issued by a United States Magistrate, the Service seized respondent's inventory, equipment, and other tangible property (Pet. App. 1a-2a).

On January 15, 1981, the day following the Service's levy, respondent filed a petition for reorganization under Chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the Western District of New York. Pursuant to the provisions of the Bankruptcy Code, respondent became a "debtor-in-possession" authorized to continue to operate its business during the pendency of the reorganization (Pet. App. 2a-3a).

One month later, the Internal Revenue Service sought to sell the seized property in order to apply

the proceeds to respondent's delinquent tax debt. On February 18, 1981, the government therefore commenced an adversary proceeding in the bankruptcy court seeking a determination that the automatic stay provision of the bankruptcy law (11 U.S.C. (Supp. IV) 362) did not bar its proposed sale of the seized property, and that it be permitted to sell the property it had seized from respondent. Respondent counterclaimed, seeking an order requiring the United States to turn over the seized property to it pursuant to Section 542 of the Bankruptcy Code (Pet. App. 1a-2a).

The bankruptcy court agreed with the government that, under the law then applicable in the Western District of New York (see *In re Avery Health Center, Inc.*, 7 Bankr. Ct. Dec. (CRR) 210 (W.D. N.Y. 1981)), respondent was not entitled to compel a turnover of the property under Section 542. In so holding, the bankruptcy court ruled that only "property of the estate"—i.e., interests in property belonging to the debtor at the time of the filing of the bankruptcy petition—is required to be turned over to a debtor pursuant to Section 542. Because the debtor had no right to have the property returned at the time the petition was filed, unless it paid its delinquent federal taxes, the seized property was not "property of the estate" that would have been subject to a turnover order under Section 542.

The bankruptcy court nevertheless ordered the government to turn over the seized property on the ground that the government was a "custodian" within the meaning of Section 543 of the Bankruptcy Code (11 U.S.C. (Supp. IV)), and was therefore required by that Section to deliver to the trustee the "property of the debtor" under its control. However, the bank-

ruptcy court conditioned the government's delivery of the property upon respondent's payment to the government of $20,000 in order to protect the government's interest in the seized property (Pet. App. 39a-43a).[1]

On appeal, the district court upheld the government's position in all respects. It ruled that the government was not a "custodian" subject to the turnover provisions of Section 543 with respect to property seized by a tax levy executed before a bankruptcy petition is filed. Following its decision in *Avery Health Center*, *supra*, the district court also rejected the debtor's contention that the government could be compelled pursuant to Section 542 to turn

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[1] The $20,000 amount which the bankruptcy court ordered paid to the government as a condition of turnover erroneously included $15,000 contained in a bank account which the government had also seized by a pre-petition tax levy. The propriety of that seizure was never put at issue in this litigation. Hence, the net effect of the bankruptcy court's order required respondent to pay over only an additional $5,000 to the government as a condition of turnover. That $5,000 amount was considerably less than the $22,450 to $35,000 that an expert witness estimated that the government might be able to obtain upon a sale of the seized property. Accordingly, the government took the position in the district court that the bankruptcy court's order did not provide adequate protection of the government's interests in the seized property during reorganization. Because the district court sustained the government's contention that the debtor was not entitled to a turnover order, it did not reach this issue. The court of appeals, however, concluded that turnover was authorized with respect to property seized by means of pre-petition levy. It therefore remanded the case with instructions to the bankruptcy court to address and redetermine the issue of the adequacy of the protection before any new turnover order is issued (Pet. App. 2a, 31a-32a). The property remains unsold in the government's control, pending the disposition of the case by this Court.

over the seized property. The district court therefore reversed the order of the bankruptcy court requiring the government to deliver the property to the debtor (Pet. App. 46a-51a).

The court of appeals reversed. Although it agreed with the district court that the government is not a "custodian" of property seized by a tax levy within the meaning of Section 543 (Pet. App. 7a-10a), it concluded that the government could be ordered to turn over such property under Section 542, provided the debtor could demonstrate that the government's interest in the property would be adequately protected (Pet. App. 10a-32a).

In so holding, the court—"conceding the question to be a close one" (Pet. App. 2a)—acknowledged that there was "some force" (*id.* at 12a) in the government's construction of the pertinent statutes, and that the only other court of appeals that had considered the question had upheld the government's position. *Cross Electric Co.* v. *United States*, 664 F.2d 1218 (4th Cir. 1981) (Pet. App. 2a). Nevertheless, the court's review of the cases regarding the turnover authority of the bankruptcy courts, with respect to collateral held by secured creditors under Chapters X and XII of prior law, and of the testimony before congressional committees during the hearings leading to the enactment of the Bankruptcy Code, led it to believe that Congress must have intended to incorporate in the new Bankruptcy Code the rule with respect to turnover authority that had developed in the decisions under the old Bankruptcy Act (Pet. App. 12a-23a).[3] In the court's view, the govern-

[3] Prior to the enactment of the Bankruptcy Code, bankruptcy proceedings were conducted pursuant to a body of federal statutory law commonly referred to as the "Bankruptcy Act" which consisted of the provisions of the Bankruptcy Act

ment's position subsequent to a tax levy was analogous to that of a private secured creditor who was subject to turnover authority under Chapters X and XII of the superseded Bankruptcy Act. Accordingly, even though there was no established principle of prior law that the government must turn over property seized by a tax levy, the court of appeals concluded that the turnover authority survived the enactment of the new Bankruptcy Code, and extended to property seized by a federal tax levy prior to the filing of the bankruptcy petition (*id.* at 23a-31a). The court of appeals therefore remanded the case to the bankruptcy court to "consider whether a turnover order is appropriate under present circumstances and, if it decides in the affirmative, what protection should be afforded to the United States" (*id.* at 32a).

SUMMARY OF ARGUMENT

1. Under Section 542(a) of the new Bankruptcy Code, persons holding property which the trustee may "use, sell, or lease," but which is out of the immediate possession of the debtor, must turn over such property to the trustee appointed to oversee the estate. Section 363 states that the trustee may "use, sell, or lease" the "property of the estate." Thus, Section 542 authorizes the turnover of "property of the estate."

In turn, for present purposes, Section 541(a)(1) of the Bankruptcy Code defines "property of the estate" to include "all legal or equitable interests of the

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of 1898 (ch. 541, 30 Stat. 544), as revised, supplemented, and amended. Although for convenience we have referred to the provisions of the Bankruptcy Act as "prior law," in general those provisions remain applicable with respect to bankruptcy proceedings that were instituted before October 1, 1979. See Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, Sections 402(a) and 403(a), 92 Stat. 2682 and 2683; compare, for example, Section 403(b), 92 Stat. 2683.

debtor in property *as of the commencement of the case*" (emphasis supplied). Thus, the estate includes only the debtor's interests in property as of the date on which a petition is filed under the Bankruptcy Code. By virtue of Section 541(a)(1), the estate acquires only the debtor's interests in property. If the debtor's interests in property are limited, then the estate acquires only those limited interests. Hence, if the debtor lost his interests in certain property prior to the filing of the bankruptcy petition, such property is not "property of the estate" and need not be turned over to the trustee under Section 542(a). Simply put, the scope of the relevant statutory definition of "property of the estate" is not intended to expand the debtor's rights vis-a-vis third parties beyond what he would have had in the absence of bankruptcy.

That fundamental principle upon which the statute is based governs this case. Here, respondent filed a petition for reorganization under the new Bankruptcy Code *after* the government had exercised its statutory right to collect delinquent taxes from it by levy upon certain of its tangible property. The relevant provisions of the Internal Revenue Code make it clear that subsequent to a levy, the debtor's rights in the seized property are exceedingly limited. As this Court stated in *Phelps* v. *United States*, 421 U.S. 330, 337 (1975), a decision which the court below sought unsuccessfully to distinguish, "The levy, therefore, gave the United States full legal right to the [property] levied upon as against the claim of the petitioner receiver." In such circumstances, the debtor retains only the right to "redeem" the property by paying the amount of tax due (26 U.S.C. 6337(a)), to receive notice of sale of the property (26 U.S.C. 6335(b)), and to obtain any surplus in the proceeds realized at sale (26

U.S.C. 6342). Since the debtor does not have the right prior to filing for reorganization to return of property seized for payment of taxes, unless he pays his arrearages in full, the debtor's estate obtains only that conditional right at the time of the filing for reorganization.

2. a. Although the court of appeals found "some force" (Pet. App. 12a) in the foregoing construction of the statute based upon the plain language and accompanying legislative history, it concluded that it "ultimately must reject it" (*ibid.*). The court's analysis proceeded upon a three-step syllogism. First, the court noted that under Chapters X and XII of prior bankruptcy law, a bankruptcy court could order secured creditors who had lawfully repossessed property of the debtor, but had not yet disposed of it, to turn over such property to the reorganizing debtor. Although the court of appeals observed that no specific provisions comparable to the prior law were enacted as part of the new Bankruptcy Code, it believed that Congress could not have intended to discontinue that authority. It therefore inferred, largely on the basis of the statements of certain witnesses before the congressional committees, that the old turnover rule was carried forward in the new statute. The second step in the court's reasoning was to analogize the government's position after a tax levy to that of a secured creditor who had repossessed the debtor's property. Finally, the court concluded that the debtor is as entitled to turnover of property seized to satisfy delinquent taxes as it is to turnover of collateral in the possession of a secured creditor.

But even if we assume that the court of appeals correctly inferred that Congress intended to incorporate in the new Bankruptcy Code a turnover rule with re-

spect to secured creditors, that conclusion furnishes no support for the third step of its analysis—its extension of the turnover rule to the government's seizure of property by a pre-petition tax levy. Under prior law, property seized by a pre-petition tax levy was not subject to turnover authority either in liquidating bankruptcies (*Phelps* v. *United States*, *supra* or in Chapter XI proceedings (*In re Pittsburgh Penguins Partners*, 598 F.2d 1299 (3d Cir. 1979)). Accordingly, there was no established rule under prior law requiring the government to surrender property seized by a pre-petition tax levy. Indeed, the rule under prior law favored the government's pre-petition tax levies.

The court's conclusion that there was such a turnover rule in Chapters X and XII proceedings to which the government was subject (although no case had so held) and its inference that Congress had codified it (although the legislative history makes no mention of it) are flatly at odds with the legislative process leading to the enactment of the Bankruptcy Code. As this Court has often stated, "[i]t will not be inferred that the legislature, in revising and consolidating the laws, intended to change their policy, unless such intention be clearly expressed." *United States* v. *Ryder*, 110 U.S. 729, 740 (1884). Accord: *Aberdeen & R.R.R.* v. *Students Challenging Regulatory Agency Procedures*, 422 U.S. 289, 309 n.12 (1975).

b. Moreover, in analogizing the government's position as a tax collector to the position of a secured creditor, the court of appeals disregarded the substantial differences between the consensual relationship of a private creditor and his debtor, and the involuntary relationship of the government and a de-

linquent taxpayer. Here, unlike a consensual private creditor, the government became an involuntary creditor because the "debtor has simply helped itself to amounts withheld from employees" (Pet. App. 31a). Such "trust fund" taxes are not "property of the estate" under Section 541(a) even when the collected taxes are in the debtor's possession at the time the petition is filed. 124 Cong. Rec. 32417, 34016-34017 (1978). Hence, if the withheld taxes were still in the debtor's possession, they would not be property available for the debtor's use. Ironically, however, under the court of appeals' decision, if the government has taken active steps to collect by levy delinquent amounts due for such withholding taxes, the court would require that the seized property be returned to the debtor for its use. Such a result unjustly rewards the debtor for its misappropriation of the government's funds.

3. At all events, there is no basis for the court of appeals' initial premise that Congress intended Section 542(a) to require secured creditors to turn over repossessed collateral. A court's first duty in interpreting a statute is to look to the terms employed in a statutory provision where the terms are plain and that method produces a reasonable result. See, e.g., *Commissioner* v. *Brown*, 380 U.S. 563, 571 (1965); *Consumer Product Safety Commission* v. *GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980); *Middlesex County Sewerage Authority* v. *National Sea Clammers Association*, 453 U.S. 1, 13 (1981); *Rubin* v. *United States*, 449 U.S. 424, 430 (1981); *Howe* v. *Smith*, 452 U.S. 473, 480, 483 (1981); *United States* v. *Turkette*, 452 U.S. 576, 580 (1981).

Here, the terms of Section 542 cannot be reconciled with the court of appeals' interpretation. Section

542(a) contains no requirement that repossessed collateral be surrendered. The statutory language provides no support for the court's conclusion that secured creditors are subject to turnover authority. Moreover, the legislative history demonstrates that the court of appeals erred in defining the scope of property subject to turnover. In considering legislative history, it is well established that the text of the final House and Senate committee reports explaining the measure at issue, as well as the explanatory remarks concerning the legislation made by the chief sponsors thereof just prior to final passage, are of primary value. *United States* v. *International Union United Automobile Workers*, 352 U.S. 567, 585 (1957); *NLRB* v. *Fruit & Vegetable Packers & Warehousemen*, 377 U.S. 58, 66 (1964).

The court of appeals gave no weight to the explanations in those primary legislative sources. Rather, the court rested its conclusion largely upon its belief that Congress intended to retain prior law regarding turnover, despite Congress' failure to employ terms accomplishing that end or to make its desire to do so explicit in the House and Senate committee reports. Finally, the court relied upon the statements and proposals of witnesses in hearings before congressional committees, referring to proposals and suggested terms that were not employed in the statute Congress ultimately enacted.

In sum, the legislative history falls far short of even suggesting, much less demonstrating, that Congress agreed with the testimony of the witnesses, upon which the court of appeals relied. Hence, there is no convincing evidence for the court's premise that Congress intended to codify a rule that would subject secured creditors to turnover of repossessed collateral, much less its ruling here extending such a "rule" to the government's pre-bankruptcy tax levies.

ARGUMENT

A BANKRUPTCY COURT IN A REORGANIZATION PROCEEDING MAY NOT COMPEL THE GOVERNMENT TO RETURN TO THE DEBTOR-IN-POSSESSION PROPERTY WHICH THE GOVERNMENT HAD SEIZED BY LEVY TO SATISFY THE DEBTOR'S DELINQUENT FEDERAL TAX LIABILITIES PRIOR TO THE FILING OF THE BANKRUPTCY PETITION

A. The Bankruptcy Code requires the turnover to the debtor-in-possession of only those interests in property that the debtor possessed as of the filing of the bankruptcy petition

This case presents an important question, on which the courts of appeals have divided, concerning the relationship of the provisions of the new Bankruptcy Code to the government's statutory authority to collect delinquent federal taxes by seizure of property. Under the new Bankruptcy Code, persons in possession of certain prescribed property of a debtor seeking the protection of the bankruptcy laws must turn over such property to the trustee appointed to oversee the estate. The property subject to this "turnover" authority generally includes "property of the estate"—all interests of the debtor in property as of the commencement of the case, i.e., as of the date of the filing of the bankruptcy petition. Hence, if the debtor lost his interest in certain property prior to the filing of the bankruptcy petition, such property is not "property of the estate" and need not be turned over to the trustee. Simply put, the relevant statutory definition of the "property of the estate" is not intended to expand the debtor's rights vis-a-vis third parties beyond what he would have had in the absence of bankruptcy.

That fundamental principle upon which the statute is based governs the outcome of this case. Here,

respondent filed a petition for reorganization under the new Bankruptcy Code *after* the government had exercised its statutory right to collect delinquent withholding taxes from it by levy upon certain of its tangible property. In these circumstances, under the pertinent provisions of the Internal Revenue Code, which prescribe the nature and extent of a delinquent taxpayer's interest in property subsequent to levy, the tax levy served substantially to terminate respondent's property interest in the assets seized by the Internal Revenue Service. Hence, as we shall show, the seized assets were not "property of the estate" subject to the turnover provisions of Section 542(a) of the Bankruptcy Code. The government's indisputably proper tax levy should not, as the court of appeals mistakenly held, be defeated by respondent's subsequent filing of a Chapter 11 petition. Nothing in the terms of the relevant statutory provisions or in their legislative history suggests that Congress intended to impose such a fundamental limitation upon the effectiveness of federal tax levies.

1. a. We begin our analysis with the language of the pertinent provisions of the Bankruptcy Code. Section 542 of the new Bankruptcy Code[3] (Pet. App. 54a) is entitled "Turnover of property to the estate."

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[3] The Bankruptcy Code is a comprehensive codification and revision of bankruptcy law. It was enacted on November 6, 1978, as the Bankruptcy Act of 1978 (Pub. L. No. 95-598, 92 Stat. 2549), and became effective in most respects on October 1, 1979. See generally *Northern Pipeline Construction Co.* v. *Marathon Pipeline Co.*, No. 81-150 (June 28, 1982). Although the Court there held that the broad grant of jurisdiction to the bankruptcy judges violated Article III of the Constitution, the substantive rules contained in the new Bankruptcy Code and applied in this case are not implicated by that decision. See *United States* v. *Security Industrial Bank*, No. 81-184 (Nov. 30, 1982), slip op. 4 n.5.

It is placed in Chapter 5 of the Code and therefore applies in all bankruptcy proceedings. See 11 U.S.C. 103(a). Section 542(a) provides that property which the trustee may "use, sell, or lease," but which is in the hands of an entity [4] and therefore out of the immediate possession of the debtor, must be turned over to the trustee appointed to oversee the estate.[5] The provision states that—

> an entity * * * in possession, custody, or control during the case, of property that the trustee may use, sell, or lease under section 363 of this title * * * shall deliver to the trustee, and account for, such property or the value of such property, unless such property is of inconsequential value or benefit to the estate.

Section 542(a) specifies that the property subject to turnover is property that "the trustee may use, sell, or lease under section 363" of the Bankruptcy Code. In turn, Section 363 (Pet. App. 52a) generally provides that the property that the trustee may "use, sell, or lease" is the "property of the estate." Specifically, Section 363(b) states, in pertinent part, that "[t]he trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate." Section 363(c)(1) directs that where the debtor's business is authorized to be operated, the trustee may use "property of the estate" without notice or a hearing "in

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[4] For purposes of the Bankruptcy Code, an entity is defined to include a "person, estate, trust, [or] governmental unit." 11 U.S.C. (Supp. IV) 101(14).

[5] In certain cases arising under Chapter 11 of the Bankruptcy Code, such as the instant case, the debtor itself remains in possession of the assets of the estate; the "debtor-in-possession" in such cases has all of the rights, powers, and duties of a trustee. See 11 U.S.C. (Supp. IV) 1107(a).

the ordinary course of business." Section 363(c), however, provides that when another entity has an interest in the "property of the estate," the trustee may use, sell, or lease it only if it can provide "adequate protection" to that entity.[8] Hence, the net effect of Sections 363 and 542 of the Bankruptcy Code is that the only category or property that is subject to the turnover provisions of Section 542(a) is "property of the estate."

The legislative history confirms the correctness of our submission that the turnover authority is limited to "property of the estate." As the pertinent House and Senate Reports explained in connection with Section 542(a) (emphasis supplied):

> Subsection (a) of this section requires anyone holding *property of the estate* on the date of the filing of the petition, or property that the trustee may use, sell or lease under section 363, to deliver it to the trustee. The subsection also requires an accounting. The holder of the property of the estate is excused from the turnover requirement of this subsection if the property held is of inconsequential value to the estate.

H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 369 (1977); S. Rep. No. 95-989, 95th Cong., 2d Sess. at 84 (1978). The property that must be turned over pursuant to Section 542(a) is that "property of the estate" which the trustee is entitled to use, sell or lease.

b. The definition of "property of the estate" is similarly precise and explicit. For present purposes, Section 541(a)(1) of the Bankruptcy Code defines

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[8] Upon the request of an entity having an interest in the "property of the estate" that the trustee proposes to use, sell or lease, Section 363(e) requires that "the court shall prohibit or condition such use, sale, or lease as is necessary to provide adequate protection of such interest."

"property of the estate" to include "all legal or equitable interests of the debtor in property *as of the commencement of the case*" (emphasis supplied).[7] Thus, the estate includes only the debtor's interests in property as of the date on which a petition is filed under the Bankruptcy Code.[8] The debtor's interest in such property becomes "property of the estate" without regard to whether the debtor has title to the property or has possession of it. H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 367-368 (1977); S. Rep. No. 95-989, 95th Cong., 1st Sess. 82-83 (1978).

Although the scope of Section 541(a) is broad, it is not unlimited. The legislative history makes it clear that the provision was not intended to enlarge the debtor's rights in property beyond those available to the debtor at the time the bankruptcy petition is filed.[9] Thus, the House and Senate Reports state

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[7] Other subsections of Section 541(a) (see Section 541(a)(2) through (7)) specify that "property of the estate" includes additional property interests in which the debtor had no right as of the commencement of the case. For example, property of the estate includes property that a custodian must turn over pursuant to Section 543, property that the trustee recovers by using his avoiding powers (see Sections 544, 545, 547, 548 and 550), and other specified interests. See, e.g., 11 U.S.C. 541(a)(3). Neither respondent nor the court of appeals relied upon any of these provisions, and they are not relevant to the instant case. Indeed, the court of appeals pointed out that Section 541(a)(1) defines the extent of the estate "with exceptions not here relevant" (Pet. App. 11a). Thus, the question presented in this case turns on the scope of the general definition of "property of the estate" set forth in Section 541(a)(1).

[8] A case is comemnced by the filing of a petition under Sections 301, 302, or 303 of the Bankruptcy Code. See 11 U.S.C. (Supp. IV) 541(a).

[9] After the case is commenced, in some circumstances the trustee may have different rights than the debtor would have

(H.R. Rep. No. 95-595, *supra*, at 367-369; S. Rep. No. 95-989, *supra*, at 92 (emphasis supplied)) that—

> this paragraph [Sec. 541(a)(1)] * * * *is not intended to expand the debtor's rights against others more than they exist at the commencement of the case.* For example, if the debtor has a claim that is barred at the time of the commencement of the case by the statute of limitations, then the trustee would not be able to pursue that claim, because he too would be barred. He could take *no greater rights than the debtor himself had.*

The remarks of the principal congressional sponsors of the Bankruptcy Code just prior to enactment are to the same effect.[10] While acknowledging that Section 541(a) is an "all-embracing definition" which

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had. For example, the trustee has an additional time period in which to pursue a claim, where the statute of limitations had not expired prior to filing the petition for relief under the Bankruptcy Code. See 11 U.S.C. (Supp. IV) 108; see also H.R. Rep. 95-595, *supra*, at 367; S. Rep. No. 95-989, *supra*, at 82. Such exceptions to the general rule that the estate acquires whatever rights the debtor had are explicity set forth in the Bankruptcy Code.

[10] Although there were substantial differences between the House (H.R. 8200, 95th Cong., 1st Sess. (1977)) and the Senate (S. 2266, 95th Cong., 2d Sess. (1978)) versions of the proposed Bankruptcy Code, time constraints prevented the preparation of a conference committee report reconciling these differences. Instead, Representative Don Edwards and Senator DeConcini made oral reports to Congress on the results of the closed-door conferences. See 124 Cong. Rec. 32391-32392 (1978) (Statement of Rep. Edwards); 124 Cong. Rec. 33990 (1978) (Statement of Sen. DeConcini). See *Northern Pipeline Co.* v. *Marathon Pipeline Construction Co.*, *supra*, slip op. 10-11 n.12; see generally, K. Klee, *Legislative History of the New Bankruptcy Code*, 28 De Paul L. Rev. 941 (1979) (*reprinted in* 54 Am. Bankr. L.J. 275 (1980)).

includes all "beneficial rights and interests" that the debtor may have, they nevertheless pointed out that (124 Cong. Rec. 32399, 33999 (1978) (emphasis added))—

> * * * *only the debtor's interest* in such property *becomes property of the estate.* If the debtor holds bare legal title or holds property in trust for another, only those rights which the debtor would have otherwise had emanating from such interest pass to the estate under Section 541.

Finally, the legislative history contains numerous similar descriptions of Congress' intent. For example, Representative Edwards, the chief House sponsor of the Bankruptcy Code, stated that Section 541(d) "reiterates the general principle that where the debtor holds bare legal title without any equitable interest, the estate acquires bare legal title without any equitable interest in the property." 124 Cong. Rec. 32399 (1978). He added that the converse proposition is also true (*ibid.*; emphasis added):

> Similarly, if the debtor holds an equitable interest in property without legal title, the estate would acquire only the equitable interest of the debtor in property and not the legal title. Thus, as section 541(a)(1) clearly states, the estate is comprised of all legal or equitable interests of the debtor in property as of the commencement of the case. *To the extent such an interest is limited in the hands of the debtor it is equally limited in the hands of the estate* except to the extent that defenses which are personal against the debtor are not effective against the estate.

See also 4 *Collier on Bankruptcy* ¶ 541.24, at 541-88 (15th ed. 1979). Indeed, Congress' belief that this principle was clearly established resulted in its deletion of two provisions based upon the principle. The Senate had proposed that Section 541 expressly pro-

vide that property of the estate does not include amounts held by the debtor as trustee or any taxes withheld or collected from others before the commencement of the case. These provisions were omitted as unnecessary because only the "legal and equitable interests of the debtor" become property of the estate. 124 Cong. Rec. 32417, 34016-34017 (1978).

In sum, the legislative history reinforces the plain meaning of the statutory language of Section 541(a)(1)—that by virtue of the general rule of that provision, the estate acquires only the debtor's interests in property as of the time the bankruptcy petition was filed. To the extent that the debtor's interests in property at that time were limited, the estate acquires only those limited interests. 4 *Collier on Bankruptcy*, *supra* (15th ed.), ¶ 541.01, at 541-5 to 541-7. Accordingly, under the plain terms of the relevant provisions and the explanations set forth in the House and Senate reports, the "property of the estate" which the bankruptcy court could require to be turned over to the debtor-in-possession under Section 542(a) consisted only of the debtor's interests in property as of the date it filed its petition for relief pursuant to the Bankruptcy Code. We turn now to consider what interests respondent had in the property seized by the Internal Revenue Service and whether those interests were includable in the "property of the estate."

B. The property seized by the Internal Revenue Service was not part of the "property of the estate" as of the time the debtor filed its bankruptcy petition because it had no right to return of the property without payment of its delinquent tax liabilities

1. The Bankruptcy Code does not itself define the property interests of a debtor. Hence, the extent of respondent's interest in the seized property at the

time it filed its bankruptcy petition must be determined by reference to non-bankruptcy law. 4 *Collier on Bankruptcy, supra* (15th ed.), ¶ 541.02[1], at 541-10. Here, since the Internal Revenue Service seized the property pursuant to a levy authorized by Section 6331 of the Internal Revenue Code to satisfy the debtor's federal tax liabilities, the interest of respondent in the property subsequent to the levy must be determined by reference to the Internal Revenue Code.

The relevant provisions of the Internal Revenue Code establish that subsequent to a levy, a taxpayer's rights with respect to the seized property are extremely limited. Section 6331(a) provides that "[i]f any person liable to pay any tax neglects or refuses to pay the same within 10 days after notice and demand, it shall be lawful for the Secretary *to collect such tax* * * * *by levy* upon all property and rights to property * * * belonging to such person or on which there is a lien" (emphasis supplied). Section 6331(b) defines a levy to include "the power of distraint and seizure by any means." [11] Section 6332(a) requires any person holding property upon which a levy has been made to "surrender such property or rights * * * to the Secretary" and, pursuant to Section 6332(c), any person who refuses to surrender property subject to levy "shall be liable in his own person and estate to the United States in a sum equal to the value of the property or rights not so surrendered" to the extent of the amount of the

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[11] Section 6331(a) of the 1954 Code has its roots in similar provisions contained in the 1939 Code (see, e.g., Sections 3690, 3692 and 3700 (1939 ed.), the Rev. Stat. (Sections 3187, 3188 and 3196 (1878 ed.)), and earlier provisions (see, e.g., Act of July 13, 1866, ch. 184, Section 9, 14 Stat. 107).

taxes "for the collection of which such levy has been made."

A person who honors a levy is "discharged from any obligation or liability to the delinquent taxpayer with respect to such property or rights to property arising from such surrender or payment." 26 U.S.C. 6332(d); see *Sims* v. *United States*, 359 U.S. 108 (1959).[12] The delinquent taxpayer and other persons are prohibited from restraining the collection of the taxes. See 26 U.S.C. 7421(a). Accordingly, once the Internal Revenue Service seizes property by levy, the delinquent taxpayer can no longer exercise the basic rights of ownership. He is not entitled to possession or use of the property, nor can he defeat the collection of the taxes by transferring title to some other party. Instead, the Service is empowered to sell the property and to convey to the purchaser "all right, title, and interest of the party delinquent in and to the property sold." 26 U.S.C. 6331(b), 6339(a)(2) and 6339(b)(1).

We do not suggest that the taxpayer has no interest at all with respect to property that has been seized by levy to satisfy his delinquent taxes. A taxpayer is entitled to notice of the seizure and sale. 26 U.S.C. 6335(a) and (b). In addition, he may redeem the property prior to sale by full payment of the delinquent taxes and the expenses of levy, and, in the case of real property, for a period of 120 days [12a] after

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[12] Payment of a debt to the government pursuant to a tax levy is a complete defense against any action the taxpayer might bring. *United States* v. *Bowery Savings Bank*, 297 F.2d 380, 382 (2d Cir. 1961).

[12a] Subsequent to the levy in this case, Section 6337(b) was amended by Section 349A(a) of the Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, 96 Stat. 639, to extend the time for redemption to 180 days.

the sale, he may redeem by payment to the purchaser of the amount the purchaser paid at the tax sale, plus interest. 26 U.S.C. 6337(a) and (b). In the event the sale results in surplus proceeds after deduction of the expenses of levy and sale, any specific tax liability on the seized property, and the liability for which the property was seized, the taxpayer is entitled to receive the surplus. 26 U.S.C. 6342(b); see also Treasury Regulations on Procedure and Administration (1954 Code), Section 301.6342-1(b) (26 C.F.R.).[13]

Undoubtedly, the debtor in this case possessed these rights and they passed to the estate when it filed the petition pursuant to the Bankruptcy Code. See generally 4 *Collier on Bankruptcy*, *supra* (15th ed.), ¶ 541.07[3], at 541-29 to 541-30. But these limited rights did not include the right to use and possession of the property absent payment of the taxes. Here, respondent condededly owed $92,000 in withholding and employment taxes. The property seized by the Service would yield at most $35,000 on sale. Hence, respondent's rights to any surplus proceeds on the sale of the property are entirely illusory and no one would expend $92,000 to redeem property worth only $35,000. The critical fact is that once the Internal Revenue Service had seized the property,

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[13] Subsequent to a tax levy, a taxpayer also retains the right to institute a suit for a refund, if there is some basis for challenging the tax liability on the merits. Thus, any right to a refund possessed by the debtor here was property which passed to the estate when the petition for reorganization was filed. See H.R. Rep. No. 95-595, *supra*, at 367; *Segal* v. *Rochelle*, 382 U.S. 375 (1966). Under the provisions of the new Bankruptcy Code, the Bankruptcy Court may hear a suit for refund after the prerequisites of suit are met. See 11 U.S.C. (Supp. IV) 505(a)(2)(B). Respondent, however, does not claim that it is entitled to a refund.

the debtor no longer had any right to its use or possession at the time the petition was filed. In these circumstances, the seized property was not Section 541(a) "property of the estate" that the debtor in possession could "use, sell, or lease" under Section 363 and was therefore not subject to turnover under Section 542(a) of the Bankruptcy Code.

2. Given the extensive effect of a federal tax levy in terminating the delinquent taxpayer's right to use and possession, it is hardly surprising that a unanimous Court in *Phelps* v. *United States*, 421 U.S. 330, 337 (1975), characterized the effect of a tax levy as giving "the United States full legal right to the [property] levied upon as against the claim of the petitioner receiver." [14] As the Court there noted, "His-

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[14] *Bennett* v. *Hunter*, 76 U.S. (9 Wall.) 326 (1870), upon which the court of appeals relied (Pet. App. 27a), is not at variance with the Court's more recent statement in *Phelps*. Contrary to the court of appeals' view (Pet. App. 27a), the forfeiture statute at issue in *Bennett* was not "essentially the same" as the levy provision at issue in this case. The statute involved in *Bennett* provided for the forfeiture of land upon the failure of citizens in the insurgent states to pay taxes that had been imposed upon the land. 76 U.S. (9 Wall.) at 333-335. Section 4 of the Act of June 7, 1862, ch. 98, 12 Stat. 423, provided in relevant part "that the title of, in and to each and every piece and parcel of land upon which said tax has not been paid * * * shall thereupon become forfeited to the United States and upon the sale hereinafter provided for shall vest in the United States or in the purchasers at such sale * * *." The Court strictly construed the forfeiture provision, holding that the first clause did not "direct the appropriation and possession of the land," but rather stated the ground upon which forfeiture of title was based, i.e., nonpayment of taxes. Accordingly, the Court observed that by virtue of the first clause, "What preceded the sale was merely preliminary, and, independently of the sale, worked no divestiture of title" (76 U.S. (9 Wall.) at 336). It was the second clause that "was intended to work the actual investment of the title through public act of

torically, service of notice has been sufficient to seize a debt, *Miller* v. *United States*, 78 U.S. (11 Wall.) 268, 297 (1871), and notice of levy and demand are equivalent to seizure" (*ibid.*). The court of appeals sought to distinguish *Phelps* on the ground that it held only that an assignee for the benefit of creditors, holding cash levied upon by the United States prior to the delinquent taxpayer's adjudication as a bankrupt, was not subject to the summary jurisdiction of the bankruptcy court (see Pet. App. 24a-25a). But the fact that the distinction between summary and plenary jurisdiction has been abolished by the Bankruptcy Code does not undermine the force of the Court's recognition in *Phelps* that a tax levy on property substantially cuts off the delinquent taxpayer's interest in the seized property. That conclusion was a critical step in the Court's conclusion that the assignee was holding the cash on behalf of the United States and not for the bankrupt.[15]

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the government," investing title in the United States or in the purchaser (*ibid.*).

Here, on the other hand, the levy provision set forth in Section 6331(a) of the Internal Revenue Code affirmatively authorizes the Secretary of the Treasury to seize possession of property in which the taxpayer has an interest in order to satisfy his delinquent taxes. See 26 U.S.C. 6331(b); *United States* v. *Sullivan*, 333 F.2d 100, 116 (3d Cir. 1964). Hence, the forfeiture statute at issue in *Bennett* has no bearing upon the effect of the tax levy involved in this case.

[15] Contrary to the court of appeals' apparent belief (Pet. App. 26a), its conclusion that "at the commencement of the Chapter 11 proceeding Whiting had title to the goods the IRS had seized" has no bearing on the question whether the government can be compelled to turn over the seized property under Section 542(a). Under Section 541(a)(1) of the Bankruptcy Code, title is not the relevant consideration. See H.R. Rep. No. 95-595, *supra*, at 367-368; S. Rep. No. 95-989, *supra*,

Thus, a levy virtually transfers ownership of seized property to the government. *United States* v. *Eiland*, 223 F.2d 118, 121-122 (4th Cir. 1955). In a very real sense, property seized by a levy belongs to the government. *American Acceptance Corp.* v. *Glendora Better Builders, Inc.*, 550 F.2d 1220, 1222-1223 (9th Cir. 1977); *United States* v. *Sullivan*, 333 F.2d 100, 116 (3d Cir. 1964) (en banc) (the seizure of a delinquent taxpayer's property by levy is "tantamount

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at 82-83. That provision specifies that "all legal or equitable interest of the debtor in property * * * as of the commencement of the case" are the "property of the estate." As we have explained (pages 16-19, *supra*), that section is not intended to expand the debtor's rights existing as of the commencement of the case. Accordingly, only such interests as the debtor had when the petition was filed pass to the estate by virtue of Section 541(a)(1). Here, when the petition was filed, the debtor had no right to use or possession of the seized property absent full payment of the taxes due. Hence, Section 541(a)(1) did not confer such rights upon the estate.

At all events, to the extent that title is relevant, the Court in *Phelps* pointed out that "the pre-bankruptcy levy displaced any title of Chicago land and [the taxpayer]" (421 U.S. at 337 n.8). Although the court of appeals considered the foregoing statement by the Court in *Phelps*, it concluded that "The remark just quoted must be read as addressed to the particular circumstances of the *Phelps* case, where the tax claim vastly exceeded the amount of the levy and the seizure was of cash which did not need to be sold" (Pet. App. 28a). But this Court's observation in *Phelps* as to the effect of a levy cannot be so easily confined to the facts of that case. Here, too, the tax claim of $92,000 far exceeds the $35,000 value of the property seized. See also *United States* v. *Eiland*, 223 F.2d 118, 121 (4th Cir. 1955), cited with approval in *Phelps* (421 U.S. at 336). Moreover, the fact that cash was the item seized in *Phelps* is a distinction without a difference. Under the pertinent provisions of the Internal Revenue Code, it is not the sale that cuts off the debtor's right to use and possession, but the levy itself.

to a transferal of ownership"). Whether the seized property is tangible or intangible, the government has full legal right to it. *In re Pittsburgh Penguins Partners*, 598 F.2d 1299, 1302 (3d Cir. 1979); see also *Division of Labor Law Enforcement* v. *United States*, 301 F.2d 82, 84-85 (9th Cir. 1962); *In re Chantler Baking Co.*, 436 F. Supp. 169, 174 (W.D. Pa. 1977).[16]

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[16] The court of appeals was unpersuaded by various appellate precedents upon which the government relied that are in accord with this Court's recognition in *Phelps* that a tax levy gives "the United States full legal right to the [property] levied upon as against the claim of the petitioner receiver" (421 U.S. at 337). In the court of appeals' view, "The general thrust of the decisions, as distinguished from some of the language, is to the contrary" (Pet. App. 28a n.18).

But the court overlooked the fact that in upholding the government's position in *Phelps*, this Court rejected the position of the Ninth Circuit in *In re United General Wood Products Corp.*, 483 F.2d 975 (1973), that serving a notice of levy was insufficient to transfer the debtor's interest in property to the government, where the property had not actually been turned over to the government before bankruptcy. In *Wood Products*, the Ninth Circuit had held that accounts receivable, which had been seized by a federal tax levy prior to bankruptcy but had remained in the hands of a third party, were in the constructive possession of the bankrupt and, thus, were subject to the bankruptcy court's summary jurisdiction. The court therefore concluded that the seized property was an asset of the bankruptcy estate, rejecting the government's argument that the levy reduced the property to the government's possession. Hence, *In re Brewster-Raymond Co.*, 344 F.2d 903, 909-910 (6th Cir. 1965), cited with approval by the court below (Pet. App. 28a n.18) and by the now discredited decision in *Wood Products*, is no longer valid precedent. It held that a federal tax levy merely perfects the government's tax lien and does not transfer title. In *Phelps*, however, the Court rejected such an analysis, ruling that a federal tax levy gave the government "full legal right to the property" and

Accordingly, pursuant to Section 541(a)(1) of the Bankruptcy Code, the debtor's rights to receive notice of sale, to redeem, and to receive any surplus proceeds passed to the estate upon the filing of the petion. But once the property had been seized by levy, it could not become property of the estate unless the debtor paid its delinquent tax liability.[17] As the

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pointing out that the levy displaced any title of the bankrupt. 421 U.S. at 337 & n.8.

Nor can the "thrust" of the decisions be so easily dismissed by confining them to their particular facts, as the court of appeals erroneously believed (Pet. App. 28a-29a n.18). Whether or not the amount of the tax debt exceeds the value of the property (as here), or whether the property is intangible or corporeal, these cases all recognized, as this Court subsequently confirmed in *Phelps*, that a levy "effects a seizure of the [debtor's] property tantamount to a transferal of ownership." *United States* v. *Sullivan*, *supra*, 333 F.2d at 116.

[17] See, e.g., *In re Avery Health Center, Inc.*, 7 Bankr. Ct. Dec. (CRR) 210, 212 (W.D.N.Y. 1981); *Parker GMC Truck Sales, Inc.* v. *United States*, 6 Bankr. Ct. Dec. (CRR) 899, 900 (Bankr. S.D. Ind. 1980); *In re Winfrey Structural Concrete Co.*, 6 Bankr. Ct. Dec. (CRR) 695 (Bankr. D. Colo. 1980); *In re Bush Gardens, Inc.* v. *United States*, 5 Bankr. Ct. Dec. (CRR) 1023 (D. N.J. 1979); *In re Paukner*, 10 Bankr. 29 (Bankr. N.D. Ohio 1981); *Douglas* v. *United States*, 7 Bankr. Ct. Dec. (CRR) 690 (Bankr. D. Neb. 1981), *In re Bishop & Son, Inc.* v. *IRS*, 19 Bankr. 633 (W.D. Mo. 1982); *In re Birco Mining Co.*, 8 Bankr. Ct. Dec. (CRR) 795 (N.D. Ala. 1981); *In re Cyber Electric Co.*, 18 Bankr. 921 (Bankr. E.D. Mich. 1982). Contra: *In re Aurora Cord & Cable Co.*, 2 Bankr. 342 (Bankr. N.D. Ill. 1980), aff'd, No. 80-C-396 (N.D. Ill. Dec. 1, 1981) (unpublished opinion); *Alpa Corp.* v. *IRS*, 7 Bankr. Ct. Dec. (CRR) 791 (Bankr. D. Utah 1981), appeal pending, No. C81-0490J (D. Utah); *In re Health America*, 22 Bankr. 268 (Bankr. M.D. Fla. 1982) *Bristol Convalescent Home, Inc.* v. *IRS*, 7 Bankr. Ct. Dec. (CRR) 1151 (Bankr. D. Conn. 1981)

Fourth Circuit put it in *Cross Electric Co.* v. *United States*, 664 F.2d 1218, 1220-1221 (1981), in terms that convincingly refute respondent's claim (footnote omitted):

> It is true, the debtor, even after the levy, retained the right to redeem the property by paying "the amount due, together with the expense of the proceeding, if any, to the Secretary," and, after sale, had a right to receive any surplus remaining after payment of the amount of the levy with the costs. These rights are expressly given by provisions of the Internal Revenue Code of 1954. But that right to redeem requires the debtor, and, after bankruptcy, its trustee, to pay the tax which was the subject of the levy, with costs, and, absent such payment, neither the debtor nor its trustee has any right to the possession of the property, in this case, an account receivable or a right to demand payment to them of such account. The trustee in this case has indicated no intention to redeem; in fact, it would be incredible that he would pay a tax over $40,000 in order to redeem an account of approximately $5,500 (or $10,000, as Cross contends the account actually is). Neither is there any possible likelihood of any surplus arising out of the sale or liquidation of the account levied upon. Since it is thus plain that the trustee is in no position to exercise any of the limited rights it may have to redeem the property levied upon there was no

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(debtor, however, declined to afford adequate protection and thus turnover was never in fact ordered).

Two cases involving state tax levies have required the seized property to be turned over for the debtor's use. *Troy Industrial Catering Service* v. *Michigan*, 2 Bankr. 521 (Bankr. E.D. Mich. 1980); *Barsky* v. *Commonwealth of Pennsylvania*, 6 Bankr. Ct. Dec. (CRR) 1216 (Bankr. E.D. Pa. 1981).

authority in the bankruptcy court to "dissolve" the IRS levy or to order the delivery of the account levied upon by the IRS to the trustee and the Government is entitled to collect the account pursuant to its levy.

C. In enacting the Bankruptcy Code, there is no indication that Congress intended to depart from prior law and require the government to turn over property seized by pre-petition levy to satisfy the debtor's delinquent tax liabilities

1. Although the court of appeals found "some force" (Pet. App. 12a) in the foregoing construction of the statute based upon the plain language and accompanying legislative history, it concluded that "it ultimately must reject it" (*ibid.*). We submit that the decision below is flatly at odds with the plain language of the relevant provisions of the Bankruptcy Code and the explanation of those provisions in the House and Senate reports. The court of appeals simply dismissed the government's reading of the plain terms of the statute as "mechanical" (Pet. App. 12a), and instead supplied the result it believed that Congress must have intended.

The court began its analysis by noting that under Section 257 of Chapter X and Section 507 of Chapter XII of the prior bankruptcy law (Act of June 22, 1938, ch. 575, 52 Stat. 902 and 927, 11 U.S.C. 657 and 907),[18] secured creditors who had repossessed collateral, but had not yet disposed of it, were required to turn over such collateral to the reorganizing debtor. Sections 257 and 507 explicity conferred upon trustees the right to "immediate possession of all prop-

[18] Chapter X provided for corporate reorganizations, and Chapter XII concerned real property arrangements by persons other than corporations.

erty of the debtor in the possession of a trustee under a trust deed or a mortgagee under a mortgage." In addition, a line of decisions including *Reconstruction Finance Corp.* v. *Kaplan*, 185 F.2d 791 (1st Cir. 1950)[19] had appilied this turnover authority in proceedings under Chapters X and XII to property repossessed by secured creditors, on the ground that repossessed collateral was analogous to property held by a trustee or mortgagee. The court of appeals observed that no specific provisions comparable to Sections 257 and 507 of the Act were enacted as part of the new Bankruptcy Code, and reasoned that if the government's interpretation of Sections 363, 541, and 542 of the Code were adopted, the turnover powers available in Chapters X and XII of prior law might not be available under the new Code. The court believed Congress could not have intended such a result (Pet. App. 12a-17a).

In support of its conclusion, the court of appeals cited (Pet. App. 17a-23a) the testimony of certain witnesses at the hearings on revision of the bankruptcy laws, who urged Congress to include in the new Code an explicit provision requiring secured creditors to turn over collateral that they had repossessed prior to bankrupty, and a proposal submitted by the National Bankruptcy Conference, under which "custodians" and "creditors in possession" would have been required to turn over to the trustee "property of the

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[19] See, e.g., *Grand Boulevard Investment Co.* v. *Strauss*, 78 F.2d 180 (8th Cir. 1935); *In re Prudence-Bonds Corp.*, 77 F.2d 328 (2d Cir.), cert. denied, 296 U.S. 584 (1935); *John Hancock Mutual Life Insurance Co.* v. *Casey*, 134 F.2d 162 (1st Cir.), cert. denied, 319 U.S. 757 (1943); *In re Franklin Garden Apartments, Inc.*, 124 F.2d 451 (2d Cir. 1941); *In re Third Avenue Transit Corp.*, 198 F.2d 703, 706 (2d Cir. 1952).

debtor." [20] Noting that Congress had added Section 542(a) to the proposed bill subsequent to this testimony, the court concluded that this sequence of events supported the inference that Congress intended Section 542(a) of the new Bankruptcy Code to codify the rule developed with respect to secured creditors under Sections 257 and 507 of the Bankruptcy Act (Pet. App. 17a-23a).

Having concluded that the prior turnover rule with respect to secured creditors survived the codification of the new bankruptcy statute, the court then reasoned (Pet. App. 23a-32a) that the position of the government following a tax levy is analogous to that of a secured creditor after repossession of collateral. The final step in the court's analysis was that Section 542(a) required the government to surrender to the trustee property it had seized by a levy prior to bankruptcy.

As we shall discuss in point D, pages 39-48, *infra*, we believe that the court's initial premise that Section 542(a) carried forward the prior turnover rule with respect to secured creditors is erroneous. But even if we assume *arguendo* that the court correctly inferred that Congress intended to carry forward in the new Bankruptcy Code a turnover rule with respect to secured creditors, that conclusion furnishes no support

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[20] See *Bankruptcy Act Revision: Hearings on H.R. 31 and H.R. 32 Before the Subcomm. on Civil and Constitutional Rights of the House Comm. on the Judiciary*, 94th Cong. 1st & 2d Sess., Pt. 1, at 439, 489-493; Pt. 2, at 1023; Pt. 3, at 1756-1757, 1838-1839 (1975-1976). *The Bankruptcy Reform Act: Hearings on S. 235 and S. 236 Before the Subcomm. on Improvements in Judicial Machinery of the Senate Comm. on the Judiciary*, 94th Cong., 1st Sess., Pt. 1, at 125; Pt. 2, at 464 (1976).

for its extension of the turnover rule to the government's seizure of property by a pre-petition tax levy. That final step in the court's reasoning is a radical departure from prior law. Without affirmative evidence that Congress intended to impose such a restriction upon the tax collection process, the courts should not thus impede the effectiveness of a levy.

2. The court of appeals concluded that Congress intended to incorporate in Section 542 of the new Bankruptcy Code a "rule" unexpressed by Congress that had developed (the court assumed) under case law interpreting Sections 257 and 507 of the Bankruptcy Act.[21] The essence of the court's theory was that the turnover authority in Chapters X and XII proceedings under the Bankruptcy Act was such a crucial tool of reorganizing debtors that Congress could not be thought to have omitted that authority under the new Code, without some affirmative indication that it was doing so. That reasoning, however, provides no justification for establishing a substantive rule of law requiring the turnover of property seized prior to bankruptcy to satisfy the debtor's delinquent tax liabilities. Under prior law, property seized by a pre-petition tax levy was not subject to turnover authority either in liquidating bankruptcies (*Phelps* v. *United States*, *supra*) or in Chapter XI proceedings (*In re Pittsburgh Penguins Partners*, 598 F.2d 1299 (3d Cir. 1979)). Although *Pittsburgh Penguins* arose under Chapter XI of the Bankruptcy

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[21] The court acknowledged (Pet. App. 15a-16a n.12), however, that the scope of that turnover authority was regarded as unsettled under prior bankruptcy law. See, e.g., Murphy, *Restraint and Reimbursement: The Secured Creditor in Reorganization and Arrangement Proceedings*, 30 Bus. Law. 15, 29, 39 (1974).

Act, we know of no case holding that such turnover authority can be exercised to deprive the government of property seized by a pre-petition levy under either of the two other reorganization chapters, Chapters X and XII. Accordingly, there was no established rule under prior law requiring the government to surrender property seized by a pre-petition tax levy. The court's conclusion that there was such a rule (although no case had so held) and its inference that Congress had codified it (although the legislative history makes no mention of it) are flatly at odds with the legislative process leading to the enactment of the Bankruptcy Code. Indeed, we are advised by the Internal Revenue Service that it is not aware of any instance in a Chapter X or XII proceeding in which a court ordered the turnover of property seized pursuant to a pre-petition levy.

While the court of appeals acknowledged (Pet. App. A 16a) that it should avoid declaring a major change in the law without some unambiguous indication that Congress so intended, that is precisely the course it followed in this case. In holding that the Internal Revenue Service is subject to turnover orders for property seized pursuant to levy prior to bankruptcy, the court has in fact made a drastic change in the law concerning collection of taxes, without any explicit indication in the legislative history that Congress intended so substantially to alter the long-accepted status of government tax levies. Significantly, the Senate Finance Committee Report, which summarized the important tax aspects of the proposed legislation, did not mention any intended change from prior law with respect to turnover authority in the context of a tax levy. S. Rep. No. 95-1106, 95th Cong., 2d Sess (1978). Because Congress evidenced no clear intent to change the law with respect to federal tax levies, the court of appeals' extension of the rule it believed to have

been carried forward to include tax levies was unwarranted. As this Court has often stated, "[i]t will not be inferred that the legislature, in revising and consolidating the laws, intended to change their policy, unless such intention be clearly expressed." *United States* v. *Ryder*, 110 U.S. 729, 740 (1884). Accord: *Aberdeen & R.R.R.* v. *Students Challenging Regulatory Agency Procedures*, 422 U.S. 289, 309 n.12 (1975); *Muniz* v. *Hoffman*, 422 U.S. 454, 467-472 (1975); *Fourco Glass Co.* v. *Transmirra Products Corp.*, 353 U.S. 222, 227 (1957).

Although the committee reports are replete with references to case law altered by the statutory provisions Congress enacted, neither the House nor the Senate report accompanying the legislation makes any mention of a change in the law in this regard. While it is true that certain witnesses at the hearings cited by the court of appeals (Pet. App. 19a-21a) urged Congress to grant explicit turnover authority with respect to collateral in the possession of secured creditors, there was no reference to any requirement that the government turn over property it had seized by a tax levy prior to bankruptcy. See, e.g., *Bankruptcy Act Revision: Hearings on H.R. 31 and H.R. 32 Before the Subcomm. on Civil and Constitutional Rights of the House Comm. on the Judiciary*, 94th Cong., 1st & 2d Sess., Pt. 1, at 439, 489-493; Pt. 2, at 1023; Pt. 3, at 1756-1757 (1975-1976); *The Bankruptcy Reform Act: Hearings on S. 235 and S. 236 Before the Subcomm. on Improvements in Judicial Machinery of the Senate Comm. on the Judiciary*, 94th Cong., 1st Sess., Pt. 1, at 125; Pt. 2, at 464 (1975). Furthermore, Congress did not enact the proposal of the National Bankruptcy Conference, to which the court of appeals referred (Pet. App. 20a). Instead, it enacted Section 543, which is limited in scope to

"custodians" and does not require secured creditors to surrender collateral in their possession. The comments in the relevant portions of the House and Senate reports in no way suggest that Congress intended to extend turnover authority to property seized by tax levy.[22]

Moreover, extensive consideration was given to the provisions of the Code having tax consequences.[23] Yet neither the Report of the Senate Finance Committee, nor the study prepared for the House Ways and Means Committee, both of which summarized and discussed the significant tax aspects of the proposed legislation, mentioned any change in the law with respect to turnover authority in the tax levy context. S. Rep. No. 95-1106, 95th Cong., 2d Sess. (1978); Staff of the Joint Comm. on Taxation, 95th Cong., 2d Sess., *Tax Aspects of Bankruptcy: Summary of H.R. 9973* (Comm. Print 1978). See also H.R. Rep. No. 95-595, *supra*, at 10, which indicates that "Bankruptcy is mainly a procedural device, prescribing the method of accomplishing rehabilitation or liquidation, but

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[22] Indeed, a general comment in the House report indicates that the divergence in policy with respect to taxes between the bill before the Committee on the Judiciary and the proposals of the Bankruptcy Commission and the National Conference of Bankruptcy Judges was due in part to insensitivity to tax policy and tax issues reflected in the proposals and at the hearings. H.R. Rep. No. 95-595, *supra*, at 274.

[23] In addition to the consideration given the tax consequences of bankruptcy by the respective House and Senate Judiciary Committees in their reports, the Senate Finance Committee reviewed the significant tax aspects of the proposed Bankruptcy Code and submitted a report. In addition, a study of the tax effect of bankruptcy was prepared for the House Ways and Means Committee. See Klee, *Legislative History of the New Bankruptcy Code*, 28 De Paul L. Rev. 941 (1979) (*reprinted in* 54 Am. Bankr. L.J. 275 (1980)).

generally leaving undisturbed * * * relationships that existed before bankruptcy." In these circumstances, a drastic change in the law with respect to the effect of pre-bankruptcy tax levies should not be implied.

3. Finally, in analogizing the government's position as a tax collector to the position of a secured creditor, the court of appeals disregarded the substantial differences between private creditors and the government as tax collector.

There are sharp differences between the consensual relationship of a private creditor and his debtor, and the involuntary relationship of the government and a delinquent taxpayer. See H.R. Rep. No. 95-595, *supra*, at 190. As the court of appeals noted (Pet. App. 31a), the government became a creditor here because the "debtor has simply helped itself to amounts withheld from employees." That the taxes involved included employee withholding taxes that the debtor failed to remit to the government is, as the court of appeals acknowledged, a fact "of peculiar force" (Pet. App. 31a). It also, however, serves to place the error of the decision below in sharper focus. As we have pointed out, the legislative history of the Bankruptcy Code indicates that Congress deleted a provision that would have explicitly provided that "trust fund" taxes are not "property of the estate." Since such taxes are held in trust for the government (26 U.S.C. 7501), Congress determined that a special provision excluding them from "property of the estate" was unnecessary. 124 Cong. Rec. 32417, 34016-34017 (1978). Hence, if withheld taxes are still in the debtor's possession, they are not property available for the debtor's use. Ironically, under the court of appeals' decision, if the government has taken active steps to collect by levy delinquent

amounts due for such withholding taxes, the court would require that the seized property be returned to the debtor for its use. Such a result unjustly rewards the debtor for its misappropriation of the government's funds.

Moreover, the fundamental distinctions between private creditors and the tax collector are reflected in the various collection remedies available to private creditors and the Internal Revenue Service. For example, the government is authorized to levy upon "all property and rights to property" belonging to a delinquent taxpayer, while a private secured creditor is secured only by the property specified in his security agreement or that upon which he perfects a lien by taking the steps required under local law to become a lien creditor. 26 U.S.C. 6331; cf. U.C.C. § 9-204 (1981). While the government is empowered by federal statute summarily to collect delinquent taxes by means of a levy, a private creditor must obtain the assistance of the appropriate legal officer to repossess collateral, unless the debtor peaceably relinquishes it.[24] 26 U.S.C. 6331; cf. U.C.C. §§ 9-501(1), 9-503 (1981). In short, it can not be said that the collection remedies of private creditors are as extensive as those available to the government when it seeks to collect its taxes.

Indeed, the differences between the governent's interest in tax collection and the claims of private creditors have long been reflected in the congressional resolution of the competing interests in bankruptcy proceedings of debtors, creditors, and the government. The new Bankruptcy Code was not intended to be "primarily a debtor's bill." H.R. Rep. No. 95-595,

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[24] Of course, collateral in the possession of a sheriff or other similar officer would be subject to turnover authority contained in Section 543, which applies to "custodians."

supra, at 4. Instead, Congress sought to balance the "goals of rehabilitating debtors and giving equal treatment to private voluntary creditors * * * with the interests of governmental tax authorities who, if unpaid taxes exist, are also creditors in the proceeding." S. Rep. No. 95-989, *supra*, at 13-14; see H.R. Rep. No. 95-595, *supra*, at 274; S. Rep. No. 1106, *supra*, at 2, 5. Because taxes are, as the Court stated in *Bull* v. *United States*, 295 U.S. 247, 259 (1935), the "lifeblood of government," Congress was sensitive to the impact of bankruptcy law with respect to tax matters upon the integrity of the tax system. The Senate Judiciary Committee Report noted that Congress was keenly aware that our voluntary assessment system of taxation can function only "to the extent that the majority of taxpayers think * * * [the system is] fair," and that this "presumption of fairness" must not be "jeopardized by permitting taxpayers to use bankruptcy as a means of improperly avoiding their tax debts." S. Rep. No. 95-989, *supra*, at 14. The committee also observed that "to the extent that debtors in bankruptcy are freed from paying their tax liabilities, the burden of making up the lost revenues * * * must be shifted to other taxpayers." *Ibid.* Thus, even if the collection of taxes by means of a federal tax levy is to some extent analogous to the collection of a debt by a secured creditor, as the court of appeals believed, it should not have assumed that Congress intended to treat both in the same manner. The considerations underlying the treatment of private claims and those underlying the treatment of governmental claims based on unpaid taxes are discrete.

Accordingly, the government is afforded priority with respect to specific tax claims and favorable treatment with respect to discharge. 11 U.S.C. (Supp. IV) 507 and 523. In addition, as we have indicated in

detail (page 36, *supra*), Congress has made it clear that withheld taxes are not part of the bankruptcy estate, even when the tax funds are in the possession of the debtor at the time the petition is filed and have been commingled with other assets. Compare 11 U.S.C. (Supp. IV) 363(c)(2)(B), which authorizes a trustee to use "cash collateral" in which a private creditor has an interest. Furthermore, a plan of reorganization is not to be confirmed if its "principal purpose * * * is the avoidance of taxes." 11 U.S.C. (Supp. V) 1129(d).

In sum, in extending turnover authority to include property seized by a pre-bankruptcy tax levy, the court of appeals disregarded the principle that significant substantive changes in the law are not to be declared without an unambiguous indication that Congress intended to alter the effect of pre-bankruptcy levies, and that change in the law is not required, or even suggested, by the explicit terms of the relevant statutes.

D. At all events, Section 542(a) of the Bankruptcy Code does not require secured creditors to turn over repossessed collateral

1. At all events, there is no basis for the court of appeals' initial premise that Congress intended Section 542(a) to require secured creditors to turn over repossessed collateral. A court's first duty in interpreting a statute is to give effect to the terms employed in the statutory provision, where the terms are plain and that method produces a reasonable result. See, e.g., *Commissioner* v. *Brown*, 380 U.S. 563, 571 (1965); *Consumer Product Safety Commission* v. *GTE Sylvania, Inc.*, 447 US. 102, 108 (1980); *Middlesex County Sewerage Authority* v. *National Sea Clammers Association*, 453 U.S. 1, 13 (1981); *Rubin* v. *United States*, 449 U.S. 424, 430 (1981); *Howe* v. *Smith*, 452 U.S. 473, 480, 483 (1981); *United States*

v. *Turkette*, 452 U.S 576, 580 (1981). But here, the court of appeals simply dismissed reference to the statutory terms as "mechanical" (Pet. App. 12a), and adopted an interpretation of the relevant statutes that is inconsistent with their terms. Furthermore, the court's interpretation of the statutory scheme is inconsistent with the explanations of the relevant provisions in the House and Senate reports. Finally, contrary to the conclusion of the court below, giving effect to the plain meaning of the relevant provisions does not unduly limit the substantial arsenal of tools available to the trustee to gather the debtor's assets for administration in bankruptcy proceedings.

2. The court of appeals did not explain how its statutory interpretation derives from the terms of the relevant provisions. It apparently found that turnover of repossessed collateral was authorized by Section 542(a) standing alone (see, e.g., Pet. App. 22a-23a). But that interpretation cannot be reconciled with the plain terms of that provision. Section 542(a) contains no requirement that repossessed collateral must be surrendered. Rather, by its terms, the section points to Section 363 and, through the operation of Section 363, to Section 541(a) for identification of the "property of the estate" subject to turnover.

Furthermore, the plain meaning of the relevant statutes, when interpreted together, is in conflict with the court's view. Section 542(a) directs an entity to turn over property that the trustee may use, sell or lease under Section 363. As we have explained (pages 13-16, *supra*), Section 363 specifies that under certain circumstances the trustee may use, sell or lease "property of the estate." Section 363 contains no terms indicating that the trustee may use, sell or lease repossessed collateral. Instead, it directs reference to Section 541(a), in which the term "property

of the estate" is defined. Section 541(a)(1) in turn indicates that the estate includes "all legal and equitable interests of the debtor in property as of the commencement of the case." The court of appeals' interpretation that the estate includes property in which the debtor has an interest can not be reconciled with the terms of Section 541(a)(1), limiting that which is to be included in the estate to the debtor's *interests* in property. Surely, the statutory terminology—"the interests of the debtor in property" —is a good deal narrower than the court of appeals' expansive textual revision—property in which the debtor has an interest. Simply put, the terms of Sections 363, 541(a) and 542(a) will not support the court's variant reading of the statute.

3. Even if the relevant statutory terms were ambiguous in defining the extent of property subject to a turnover order, the legislative history demonstrates that the court of appeals erred in defining the scope of property subject to turnover. In considering legislative history, it is well established that the text of the final House and Senate committee reports explaining the measure, as well as the explanatory remarks concerning the legislation made by the chief sponsors immediatley prior to final passage, are of primary value. *United States* v. *International Union United Automobile Workers*, 352 U.S. 567, 585 (1957); *NLRB* v. *Fruit & Vegetable Packers & Warehousemen*, 377 U.S. 58, 66 (1964).

Here, as we have pointed out (pages 15-19, *infra*), the Congressional reports and explanatory remarks concerning the relevant sections of the Code indicate that the substantive rule governing what property must be turned over is found in Section 541(a), not Section 542(a). The explanation concerning Section 541(a)(1) emphasizes that the general rule is that (except for rights provided the estate by other spe-

cific provisions, which are contained in Sections 541 (a)(2) through (7)) "property of the estate" consists only of the debtor's *interests in property* as of the time the petition was filed, even if the debtor held something less than full ownership or possessory right.[25]

The court of appeals gave no weight to the explanation in the foregoing primary legislative sources. Rather, the court rested its conclusion largely upon its belief that Congress intended to retain prior law regarding turnover, despite Congress' failure to employ terms accomplishing that end or make its desire

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[25] The court of appeals stated (Pet. App. 12a-13a, 29a) that its interpretation of the statute was consistent with the explanations in the House and Senate reports, citing the statement that (H.R. Rep. 95-595, *supra*, at 367; S. Rep. No. 95-989, *supra*, at 82)—

> It [Section 541(a)(1)] includes all kinds of property, including tangible or intangible property, causes of action (see Bankruptcy Act § 70a(6)), and all other forms of property currently specified in section 70a of the Bankruptcy Act, § 70a, as well as property recovered by the trustee under section 542 of proposed title 11, *if the property recovered was merely out of the possession of the debtor*, yet remained "property of the debtor." [Emphasis supplied.]

On its face, the statement indicates that the trustee may recover property for inclusion in the estate if it is "*merely* out of the debtor's possession" (emphasis supplied). Read in context, the statement does not mean that upon filing a petition in bankruptcy the debtor's rights are expanded to include a right to possession. As we have noted (pages 16-18, *supra*), the reports explain that the section is not intended to expand the debtor's rights against others more than they existed at the commencement of the case (*ibid.*). Indeed, Congress believed that under Section 541(a)(1) only the debtor's interests in property passed to the estate. It therefore deleted two provisions that would have illustrated the application of that principle. See pages 18-19, 36, *supra*.

to do so explicit in the House and Senate Committee reports. Thus, while the court stated (Pet. App. 29a) that its result is "entirely consistent" with Congress' intent that Section 541(a)(1) not serve to expand the trustee's rights beyond those of the debtor at the commencement of the case, that is simply not the case. At the time respondent filed its petition, it did not have any right to obtain the seized property absent full payment of its tax liability. The court of appeals, however, granted respondent just such an expanded right.

Furthermore, the court relied upon the statements and proposals of witnesses in hearings before congressional committees, even though the proposals and suggested terms were not employed in the statute that Congress ultimately enacted. These witnesses urged Congress to require secured creditors to turn over repossessed collateral in their possession. Moreover, the National Bankruptcy Conference proposed an explicit statutory requirement that "custodians" and "creditors in possession" turn over property in their possession. See Pet. App. 21a n.16. But there is no mention in the House and Senate reports that Congress intended to require secured creditors to turn over repossessed collateral, nor did Congress incorporate in the Code without significant amendment the proposal of the National Bankruptcy Conference. Instead, Congress enacted Section 543, which requires only "custodians" to turn over property in their possession.[26] Insofar as creditors were concerned, Congress enacted Section 542(a) and that provision contains no explicit terms requiring secured creditors to

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[26] The court of appeals agreed with our submission that the Internal Revenue Service is not a "custodian" of property seized in a levy within the meaning of Section 543(a) (Pet. App. 10a).

surrender repossessed collateral. In sum, the legislative history of the relevant provisions falls far short of even suggesting, much less demonstrating, that Congress agreed with the testimony of the witnesses.

4. a. The court of appeals further indicated that it believed that a literal interpretation of the words actually enacted in Section 542(a) would unduly restrict the function of the statute. In its view (Pet. App. 23a), if the government's interpretation of Section 542(a) were adopted, "apparently its only use would be to authorize obtaining property from persons in wrongful possession following theft or conversion."

By virtue of its terms, however, Section 542(a) is a general enforcement provision, providing the bankruptcy courts with explicit authority to order turnover of any property to which the estate is entitled under Section 541, but which remains in the possession, control or custody of another entity. For example, Section 542(a) has been invoked to enforce the right of a business involved in bankruptcy proceedings to obtain delivery or return of goods under contractual or lease arrangements.[27]

The use of Section 542(a) as a general enforcement provision is also consistent with prior law. As the Court recognized in *Maggio* v. *Zeitz*, 333 U.S. 56, 61-63 (1948), the bankruptcy courts had developed a "summary" turnover procedure under prior law that was applicable in liquidation as well as reorganization proceedings, in order to compel the sur-

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[27] See, e.g., *Fairway Records, Inc.* v. *Direct Response Productions, Inc.*, 2 Collier Bankr. Cas. 2d 1015 (Bankr. E.D.N.Y. 1980); *In re Brendern Enterprises, Inc.*, 7 Bankr. Ct. Dec. (CRR) 1137 (Bankr. E.D. Pa. 1981); *In re Janmar, Inc.*, 1 Collier Bankr. Cas. 2d (MB) 1051 (Bankr. N.D. Ga. 1980); see also *Resendez* v. *Lindquist*, 691 F.2d 397 (Bankr. 8th Cir. 1982).

render to the trustee of all property interests to which the trustee was entitled. The Court ruled that the turnover procedure was a "judicial innovation by which the [bankruptcy] court seeks efficiently and expeditiously to accomplish ends prescribed by the statute" (*id.* at 61).

A common use of the summary turnover procedure was against a bankrupt party himself who had retained assets which rightfully belonged to the estate. See *Maggio* v. *Zeitz*, *supra*, 333 U.S. at 59; *Oriel* v. *Russell*, 278 U.S. 358 (1929); *Cooper* v. *Dasher*, 290 U.S. 106 (1933). But the turnover procedure was also used in cases where entities other than the bankrupt were involved. See, e.g., *Farmers' & Mechanics' National Bank* v. *Wilkinson*, 295 F. 120, 122 (5th Cir. 1923), cert. denied, 264 U.S. 588 (1924) (bank was ordered to turn over sums it received from the bankrupt after the petition was filed); see also *Taubel-Scott-Kitzmiller Co.* v. *Fox*, 264 U.S. 426, 433 (1924); *Harris* v. *Brundage Co.*, 305 U.S. 160, 164 (1938).

b. The court of appeals further believed that giving effect to the plain meaning of the statutes would narrow the definition of "property of the estate," in derogation of the legislative history that Section 541 (a)(1) was intended to include all interests in property formerly available to the trustee under Section 70a of the Bankruptcy Act (see Pet. App. 12a-13a, n.10). But our position with respect to the general rule of Section 541(a)(1) preserves the general rule stated in Section 70a of the Bankruptcy Act, as Congress intended.

Section 70a (see Act of July 1, 1898, ch. 541, 30 Stat. 565, 11 U.S.C. 110(a)) generally included within the bankruptcy estate a broad range of the debtor's interests in property as of the date of the

filing of the bankruptcy petition.[28] See, e.g., 4A *Collier on Bankruptcy*, ¶ 70.04, at 49-62 (14th ed. 1978). It was clear, however, that Section 70a, as a general rule, vested the estate with no *greater* property rights than had been available to the debtor prior to the filing of the petition. See, e.g., *Hewitt* v. *Berlin Machine Works*, 194 U.S. 296, 302 (1904); *Security Warehousing Co.* v. *Hand*, 206 U.S. 415, 423 (1907); *Hyman* v. *McLendon*, 140 F.2d 76, 80 (4th Cir. 1944), cert. denied, 322 U.S. 739 (1944); *Schultz* v. *England*, 106 F.2d 764, 768 (9th Cir. 1939); 4A *Collier on Bankruptcy, supra* (14th ed.), ¶ 70.04, at 55-57. Section 541(a)(1) preserves these former rules.

c. Contrary to the inference drawn by the court of appeals (Pet. App. 12a-13a), it does not follow from the foregoing interpretation of Section 541(a)(1) that the trustee never has greater rights to property than the debtor had when the petition was filed. The Bankruptcy Code contains numerous provisions which expand the rights of the

[28] Section 70a consisted in large part of a detailed enumeration of specific property interests which passed from the debtor to the estate at filing. See Sections 70a(1) through (8), and the three additional (unnumbered) paragraphs of Section 70a. Section 70a(5), however, provided a broad general description of property interests passing to the estate, i.e., all "property * * * which prior to the filing of the petition [debtor] could by any means have transferred or which might have been levied upon and sold under judicial process against him." See, e.g., 4A *Collier on Bankruptcy* (14th ed. 1978), ¶¶ 70.04, 70.15, at 49-62, 135-137.

Other provisions of the Bankruptcy Act conferred avoiding powers and other rights upon the trustee that were not held by the debtor. See, e.g., Section 60 of the Bankruptcy Act (11 U.S.C. 96), which allowed the trustee to avoid "preferential" transfers of property that were made prior to bankruptcy.

trustee with respect to property beyond the scope of the predecessor Section 70a. As we have pointed out, Sections 541(a)(2) through (7) include within the definition of "property of the estate" various interests which would not otherwise be included as part of the bankruptcy estate. For example, Section 541(a)(3) makes it clear that "property of the estate" includes "[a]ny interest in property that the trustee recovers under section[s] 543 [property held by a custodian], 550 [property obtained through the use of the trustee's avoiding powers], 553 [certain property concerning which a creditor has exercised a right of set-off], or 723 [certain partnership property]."[29] Section 541(a)(2) also brings within the estate certain community property "of the debtor and the debtor's spouse." Thus, contrary to the apprehension expressed by the court below, adhering to the plain terms of Section 541(a)(1) so as to conclude that the estate has only such interests in property as the debtor had when the petition was filed does not detract from the substantial array of specific powers that the new Code gives to the representative of a debtor to assist in the debtor's reorganization.

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[29] The trustee is granted substantial avoiding powers by Sections 544 (rights as a lien creditor), 545 (power to avoid statutory liens), 547 (right to avoid preferences), 548 (right to avoid fraudulent transfers), 549 (right to avoid certain post-petition transactions), and 724(a) (power to avoid liens that secure the payment of a fine or penalty). Section 550 provides in relevant part that "to the extent that a transfer is avoided under section[s] 544, 545, 547, 548, 549 or 724(a) of this title, the trustee may recover, for the benefit of the estate, the property transferred, or * * * the value of such property." In turn, Section 541(a)(3) makes it clear that property recovered under Section 550 is "property of the estate."

d. Finally, the court of appeals concluded that "the Government's reading of the Bankruptcy Code would seriously affect the chances of success in many reorganizations" (Pet. App. 16a). Absent compelled turnover, the court apparently believed that respondent would not be able to continue in business. That may well be the case. Respondent, however, is hardly an appropriate candidate for such solicitude. As the court of appeals acknowledged, it "simply helped itself to amounts withheld from employees" (Pet. App. 31a). And only after the government exercised its right to levy, did respondent seek the protection of bankruptcy. Thus, respondent's actions come too late to compel the return of its property. Whatever protection the bankruptcy laws may provide respondent, they cannot undo the effect of a pre-petition tax levy which "gave the United States full legal right to the [property] levied upon as against the claim of the * * * [debtor-in-possession]." *Phelps* v. *United States, supra*, 421 U.S. at 337.

CONCLUSION

The decision of the court of appeals should be reversed.

Respectfully submitted.

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In The

Supreme Court of the United States

OCTOBER TERM, 1982

UNITED STATES OF AMERICA,

Petitioner,

v.

WHITING POOLS, INC.

On Writ Of Certiorari To The United States Court Of Appeals For The Second Circuit

BRIEF FOR RESPONDENT WHITING POOLS, INC.

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In The

Supreme Court of the United States

OCTOBER TERM, 1982

No. 82-215

UNITED STATES OF AMERICA,

Petitioner,

v.

WHITING POOLS, INC.,

Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Second Circuit

BRIEF FOR RESPONDENT WHITING POOLS, INC.

STATUTES INVOLVED

Sections 541(a) and 542(a) of the Bankruptcy Code, (11 U.S.C. (Supp IV)) and Section 6331 of the Internal Revenue Code (26 U.S.C) are set forth in Pet. App. 52a-56a. Sections 105(a), 106, 361, 363(a), (b), (c) (1), (2) and 543 (b) (1) of the Bankruptcy Code, Sections 6332(a); 6335; 6337; 6338; 6339(a) (1), (2), (b); 6342(b) of the Internal Revenue Code, and 28 U.S.C. §1471(e) and 1651(a) are set forth in Respondent's Appendix A, attached.

STATEMENT OF CASE

Petitioner's statement of the case is substantially accurate, though it makes some omissions which we wish to note for the Court.

In ordering the turnover at issue, the bankruptcy court below made several findings of fact that are not controverted, to wit:

1. Whiting's indebtedness to the IRS for unpaid employment taxes is approximately $92,000.00;

2. The seized assets have a going concern value of $162,876.00;

3. Other than the IRS tax lien, the only existing lien against the seized assets was a security interest owned by Marine Midland Bank in the amount of either $6,000.00 or $12,500.00.

4. Based on the above, the debtor has a substantial equity in the seized property.

5. Public sale of those assets by the IRS will yield a *maximum* of $30,000.00. — $35,000.00

(Pet. App., 35a-36a). The bankruptcy court concluded, based on these findings, that "the seized property is absolutely necessary to an effective reorganization of the debtor" since "the debtor will cease to exist" once the sale occurs. (Pet. App., 36a) Accordingly, the bankruptcy court determined that turnover is in the best interest of the government, since the IRS would recover more on its tax claim from a successfully reorganized business than from a tax sale, and its interest could be adequately protected in the interim. These factual conclusions have not been disputed by the government.

In fashioning adequate protection for the government, the bankruptcy court ordered Whiting to pay the IRS $20,000 upon the return of the seized property and to make further payments of $1,000 per month until the tax was paid. The court further

permitted IRS to retain its lien upon the seized property and provided for the lifting of the automatic stay in the event Whiting defaulted in payment. (Pet. App. 44a-45a). Although some $15,000 of the initial payment of $20,000 was to come from a bank account also subject to a pre-petition levy by the IRS (Pet. Br. p.4, n.1), the account merely was part of the total collateral held by the IRS at the time of the petition, in addition to the seized tangible assets which were worth $162,876. The power of the bankruptcy court to utilize such bank account funds as part of IRS's adequate protection remedy is coextensive with its general turnover powers which are at issue in this case.

SUMMARY OF ARGUMENT

A. Whether tangible property seized by the government by pre-petition tax levy is subject to the §542(a) turnover power of the bankruptcy court in a reorganization proceeding turns upon whether such property is "property that the trustee may use, sell or lease under Section 363". Section 363 authorizes the use, sale or lease of "property of the estate". Courts which have held that the government is beyond the scope of the turnover power have construed the phrase "property of the estate" rigidly as a term of art defined in §541(a) as "all legal or equitable interests of the debtor in property as of the commencement of the case." In this view, the turnover requirement extends only to the debtor's *interests in property;* so that the debtor's *right to possession,* at the commencement of the case, or lack thereof, is determinative of the trustee's right to turnover. The Second Circuit, like other courts which have permitted the turnover power to be employed against the government, recognized that turnover applies not to *interests* in property *per se* but to the property itself, so that under §542(a), a trustee may obtain possession of *assets* in which the debtor holds a substantial interest, subject only to the requirement that the interests of other parties in those assets be adequately

protected. The latter approach is, we believe, more consistent with the basic rehabilitative purpose of the Bankruptcy Code and applicable precedent in reorganization cases.

B. Under the government's construction of §§542(a), 541 and 363 of the Bankruptcy Code, the scope of turnover power is delimited by the debtor's non-bankruptcy interests in property, particularly the right of possession of that property. Since no meaningful distinction exists between the right of secured creditors to possession of repossessed collateral and the right of the government to possession of property seized by tax levy, the rule advocated by the government would place property repossessed by secured creditors beyond the reach of the turnover power.

C. In our view, *Phelps v. United States*, 421 U.S. 330 (1975) and other cases decided under the Bankruptcy Act which held that a trustee or receiver in bankruptcy was not entitled to obtain a turnover of property which the IRS had seized from a taxpayer prior to that taxpayer's bankruptcy are not meaningful precedent in this case. The earlier cases involved liquidation or Chapter XI proceedings in which, under the Bankruptcy Act, a determination that property was held adversely by a third party under a claim of right was sufficient to defeat the limited "summary" jurisdiction of the bankruptcy court, particularly where no statutory turnover power was provided in the Act. The elimination of the distinction between summary and plenary jurisdiction in the Bankruptcy Code, the pervasive jurisdictional grant to the bankruptcy court under 28 U.S.C. §1471(e), and the express grant of turnover power under 11 U.S.C. (Supp. IV) §542(a) all combine to make the earlier decisions under the Bankruptcy Act no longer relevant, particularly in reorganization cases under the Bankruptcy Code.

Despite the government's attempt to assert that *Phelps v. United States* and other Bankruptcy Act cases stand for the proposition that a tax levy, by itself, actually effects a transfer

of ownership of the property levied upon from the taxpayer to the government, neither the cases relied upon nor the applicable statutes so provide. None of the cases dealt with the "ownership" of *tangible* property post-seizure but prior to sale under levy, and the applicable sections of the Internal Revenue Code make it clear that the taxpayer remains the owner of seized tangible property until a sale is actually conducted and a certificate of sale or deed is delivered to the successful bidder. *Phelps* and the other pre-Bankruptcy Code cases relied upon by the government are neither applicable to the statute whose construction is at issue herein nor to the facts involved in this case.

D. Adoption of the government's superficial construction of the relevant statutes is not compelled by the plain meaning rule. That rule is not a rule of law, but an "axiom of experience" and, as such, did not bar the Court of Appeals from considering the circumstances of the enactment of §542(a). In any event, reference to extrinsic aids is necessary because the key phrase "property of the estate", as employed in §363, is ambiguous in that it appears from the context of §363 to refer to *items of property* capable of use and capable of being encumbered, yet it apparently could refer to the interests in property which comprise the estate under §541(a)(1). In addition, the "plain meaning" urged by the government yields the absurd and unreasonable result that turnover under §542(a) would be restricted to recovery of *interests* of the debtor in the "possession" of third party, when such interests are already brought into the estate by §541(a). Furthermore, resort to extrinsic aids to ascertain legislative intent was proper because the "plain meaning" urged by the government produces an unreasonable result contrary to the rehabilitative purpose of the Bankruptcy Code — a turnover power too restricted in scope to enable a bankruptcy trustee to recover property rightfully held by a secured creditor regardless of the extent of the debtor's equity or the impact on reorganization.

E. As the Court of Appeals found, §542(a) suddenly appeared in final form in H.R. 6, a draft prepared immediately after the completion of House subcommittee hearings in which every witness to address the question recommended that a provision be added to clarify that the broad turnover power applicable in reorganization cases under Chapters X and XII of the Bankruptcy Act is to be incorporated in the new Bankruptcy Code. The timing of the addition of §542(a) thus compels the inference that Congress intended to codify *Reconstruction Finance Corp. v. Kaplan,* 185 F.2d 791 (1st Cir. 1950), and subject secured creditors holding repossessed collateral to the turnover requirement. No alternative explanation of the origin of §542(a) is supported by the legislative history, and no clear statement of legislative intent to the contrary appears in either the legislative debates or the committee reports.

F. Bankruptcy Code §542(a) was intended by Congress to be a codification of the broad turnover power which had developed in Chapter X reorganization cases under the Bankruptcy Act as exemplified by the holding in *Reconstruction Finance Corp. v. Kaplan.* The primacy of the goal of rehabilitation in reorganization cases is apparent in the legislative history and explains the enactment of a comprehensive turnover power as an adjunct to the generally expanded jurisdiction of the bankruptcy court granted by the Bankruptcy Code. The narrow construction of §542(a) advocated by the government would appear to make turnover unavailable even under the facts of *Reconstruction Finance Corp. v. Kaplan,* a result clearly not intended by Congress.

G. In a reorganization case under the Bankruptcy Code, such as the present one, where the retention of possession by a third party of property essential to the debtor-in-possession's business operations will thwart an effective reorganization, the real issue should be whether the interests of the third party in

the property can be "adequately protected" if possession of the property is turned over to the debtor-in-possession.

The applicable statutory provisions, Bankruptcy Code §§361 and 363(e), and their legislative history, clearly envision broad equitable power in the bankruptcy court in this regard which was to be flexible enough to deal with the facts of each case on a case-by-case basis.

The determination of the bankruptcy court below that the seized property was essential to Whiting's ability to operate as a debtor-in-possession and that the interests of the IRS could be adequately protected by specific requirements which it imposed upon Whiting was consistent with the manner in which the bankruptcy court was intended to function under the Bankruptcy Code. Accordingly, the turnover order which was issued by the bankruptcy court against the IRS in this case was within its statutory powers.

ARGUMENT

A Bankruptcy Court in a Reorganization Proceeding under the Bankruptcy Code may require any creditor, including the government, in possession of tangible property in which the debtor retains a substantial interest, to turn over that property to the debtor-in-possession if the property is necessary to the debtor's reorganization and the interest of the creditor in the property can be adequately protected.

A. *Background.*

Section 542(a) of the Bankruptcy Code requires "an entity, other than a custodian, in possession, custody, or control, during the case, of property that the trustee may use, sell or lease under Section 363 of this title" to turn over that property to the trustee unless it is "of inconsequential value or benefit to the estate." 11 U.S.C (Supp. IV) §542(a). The ultimate issue on this appeal is a narrow question of construction of §542(a): whether, in a reorganization proceeding, tangible assets of a debtor in the possession of the IRS following a pre-petition tax levy are subject to turnover under §542(a) of the Bankruptcy Code, 11 U.S.C. (Supp. IV) §542(a), as "property that the trustee may use, sell or lease under Section 363" of the Bankruptcy Code, 11 U.S.C. (Supp. IV) §363.[1] By the terms of §363, the trustee is authorized to use, sell or lease "property of the estate," 11 U.S.C. (Supp. IV) §363(b), (c) (1); subject to the requirement that the bankruptcy court, at the request of an

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[1]The government concedes, as it must, that the IRS is a "governmental unit", and thus an "entity" as defined in 11 U.S.C. (Supp. IV) §101 (14). Pet. Br. at 14, n.4. The District Court ruled, and the Second Circuit agreed, that the IRS is not a "custodian" within the meaning of paragraph 10 of §101 of the Bankruptcy Code, 11 U.S.C. (Supp. IV) §101(10), and thus is not subject to the turnover requirement of §543, 11 U.S.C. (Supp. IV) §543(b). Pet. App. at 48a-50a; 8a-10a. It is undisputed that the IRS, as an entity, would be subject to the turnover requirement of §542(a), if it had possession, custody or control of property that the trustee may use, sell or lease.

entity with an interest in the property, "shall prohibit or condition such use, sale or lease as is necessary to provide adequate protection of such interest". 11 U.S.C. (Supp. IV) §363(e). The phrase "property of the estate" is not actually defined in §363, although §541 of the Bankruptcy Code (which bears the heading "Property of the estate") provides, in relevant part, that the bankruptcy estate is comprised of "all legal or equitable interests of the debtor in property as of the commencement of the case".[2] 11 U.S.C. (Supp. IV) §541(a) (1).

This statutory scheme is capable of, and has been subjected to, at least two plausible, but conflicting interpretations. One view, typified by the decision of the Fourth Circuit in *Cross Electric Co. v. United States*, 664 F.2d 1218 (4th Cir. 1981) and urged by the government here, holds that the phrase "property of the estate", as employed in §363 of the Bankruptcy Code, is a term of art defined by 11 U.S.C. (Supp. IV) §541(a) (1) as "all legal or equitable interests of the debtor in property as of the commencement of this case." Thus, it is argued that since the property which may be used, sold, or leased under §363 is limited to "property of the estate", only those *interests of the debtor in property* as of the date the petition was filed are subject to turnover under §542(a) of the Bankruptcy Code. Pet. Br. at 14-16, 19. Where the debtor's *interests* in an asset did not include the right to possession and use of the property at the commencement of the case, the courts espousing this view have denied turnover.[3]

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[2]Of course, a bankruptcy case is commenced by the filing of a petition. See, 11 U.S.C. (Supp. IV) §§301; 302(a); 303(b); 541(a).

[3]See, e.g., *Cross Electric Co. v. United States*, 664 F.2d 1218, *supra; In re Avery Health Center, Inc.*, 7 B.C.D. 210, 212 (W.D.N.Y. 1981); *Parker GMC Truck Sales, Inc. v. United States*, 6 B.C.D. 899, 900 (Bankr. S.D. Ind. 1980); *In re Winfrey Structural Concrete Co.*, 6 B.C.D. 695 (Bankr. D. Colo. 1980); *Bush Gardens, Inc. v. United States*, 5 B.C.D. 1023

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The competing view, to which the Second Circuit adheres, interprets §542(a) as imposing a requirement that third parties in possession, custody or control of *property in which the debtor had a substantial legal or equitable interest* as of the commencement of the case turn over that property to the trustee or debtor-in-possession.[4] *See, United States v. Whiting Pools, Inc.*, 674 F.2d 144, 149-56 (2d Cir. 1982); Pet. App. at 11a-23a. Courts adopting this construction of the statute have found support for a broad turnover power in the legislative history of the Bankruptcy Reform Act of 1978, the expanded jurisdiction of the Bankruptcy Court under that Act, and, more particularly, in a perception that Congress, especially in reorganization cases, could not have intended the consequences that flow from an overliteral construction of the phrase "property of the estate".[5] In this view, the words "property of

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(D. N.J. 1979); *In re Paukner*, 10 B.R. 29 (Bankr. N.D. Ohio 1981); *Douglas v. United States*, 7 B.C.D. 690 (Bankr. D. Neb. 1981), overruled in *In re Cudaback*, 22 B.R. 914, (Bankr. D. Neb. 1982); *In re Bishop & Son, Inc. v. IRS*, 19 B.R. 633 (W.D. Mo. 1982); *In re Birco Mining Co.*, 8 B.C.D. 795 (N.D. Ala. 1981); Cf. *In re Cyber Electric Co.*, 18 B.R. 921 (Bankr. E.D. Mich. 1982) (seizure of cash distinguishable from seizure of tangible property in that debtor retains no interest in case that could be turned over to the trustee).

[4]Under 11 U.S.C. (Supp. IV) §1107(a), a debtor in possession, with certain exceptions not relevant here, has all the rights, powers and duties of a trustee.

[5]*See, United States v. Whiting Pools, Inc.*, 674 F.2d 144, 149-56; *supra* Pet. App. at 11a-23a; *In re Aurora Cord & Cable Co.*, 2 B.R. 342 (Bankr. N.D. Ill. 1980), aff'd. No. 80-C-396 (N.D. Ill. Dec. 1, 1981) (unpublished opinion); *Alpa Corp. v. IRS*, 7 B.C.D. 791 (Bankr. D. Utah 1981), appeal pending, No. C81-0490J (D. Utah); *In re Sunrise Equip. & Dev. Corp.*, 24 B.R. 26 (Bankr. D. Ariz. 1982); *In re Health America of Florida, Inc.*, 22 B.R. 268 (Bankr. M.D. Fla. 1982); *In re Day Resource & Dev. Co.*, 21 B.R. 176 (Bankr. D. Idaho 1982); *In re Hudson Valley Ambulance Serv.*, 11 B.R. 860 (Bankr. S.D.N.Y. 1981); *Bristol Convalescent Home, Inc. v. IRS*, 7 B.C.D. 1151 (Bankr. D. Conn. 1981); *In re King*, 7 B.C.D. 530 (Bankr.

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the estate", as employed in subsections (b) and (c) of §363, are intended to refer to *assets* of the bankruptcy estate rather than to the debtor's *property interests* in those assets. Once the bankruptcy estate succeeds to the debtor's legal or equitable interests in a given asset by operation of §541(a) (1) of the Bankruptcy Code, the bankruptcy court obtains equitable jurisdiction over that entire asset, *See*, 11 U.S.C. (Supp. IV) §105; 28 U.S.C. §1471(e); 28 U.S.C. §1651; and that asset, though encumbered by the property interests of third parties, becomes property which the trustee may use, sell or lease within the meaning of §§363 and 542(a) of the Bankruptcy Code. As long as the debtor retained, at the filing of the petition, a substantial interest in an asset (such as the right to redeem property following a tax levy under 26 U.S.C. §6337 or the right, under U.C.C. §9-506, to redeem repossessed collateral, or a substantial equity in the property), the encumbered asset would be subject to turnover under §542(a) of the Bankruptcy Code, even though the third party holding the property would have the right to possession absent the pendency of the bankruptcy case. See, *United States v. Whiting Pools, Inc., supra,* at 151, 156-57; Pet. App. at 12a-13a; cf. *International Horizons, Inc.*, 21 B.R. 414 (Bankr. S.D. Fla. 1982) [debtor's insurable interest in finished goods under U.C.C. §2-501(1) too insignificant to render entire property subject to turnover]. Where the interest of that third party could not be adequately protected, however, turnover would be denied. See, 11 U.S.C. (Supp. IV) §§361, 363(e).

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M.D. Tenn. 1981); *Barsky v. Commonwealth of Pennsylvania*, 6 B.C.D. 1216 (Bankr. E.D. Pa. 1981); *Troy Indus. Catering Serv. v. Michigan*, 2 B.R. 521 (Bankr. E.D. Mich. 1980); *Accord, In re Dartmouth Nursing Home, Inc.*, 24 B.R. 256, 265 (Bankr. D. Mass. 1982); *In re Cudaback*, 22 B.R. 914, *supra*, note 3; *In re Debmar Corp.* 21 B.R. 858, 860 (Bankr. S.D. Fla. 1982); *In re International Horizons, Inc., supra* at 417; *In re Hurricane Elkhorn Coal Corp.*, 19 B.R. 609, 618 (Bankr. W.D. Ky. 1982).

Comparison of these two competing viewpoints can yield but one conclusion: that the Court of Appeals was correct in rejecting the Government's superficial and strained construction of the language of §§542, 541(a) (1) and 363 of the Bankruptcy Code in favor of a broad view of §542's turnover power consistent with the settled law of business reorganizations, the policy of the Code favoring the rehabilitation of business debtors, the intended function of the bankruptcy court as a court of equity balancing competing interests by the use of the concept of adequate protection, the legislative history of §542(a), and the language of the relevant statutes. The core concept in the government's position — that non-debtors holding a possessory interest in property of the debtor as of the filing date of a bankruptcy petition are immune from the turnover power of the bankruptcy court — is simply untenable in light of the legislative history and the drastic impact such a rule would have on the prospects for successful rehabilitation of business debtors and the ability of any debtor to use encumbered property.

B. ***For Purposes Of Turnover Under §542(a), There Is No Meaningful Distinction Between The Posture Of The IRS Following A Pre-petition Tax Levy And That Of A Secured Creditor Or Pledgee In Possession Of Collateral Following The Default Of The Debtor.***

The crux of the government's argument is that the "plain meaning' of §§541, 542 and 363 of the Bankruptcy Code dictates that only where the debtor's interests in property pre-petition included the right to possession is such property subject to turnover. Pet. Br. at 12-29. Arguing that under the Internal Revenue Code, 26 U.S.C. §6331 *et. seq.*, the limited rights remaining to a taxpayer following seizure of its assets by tax levy do not include the right to use and possession of the seized property, the government concludes that the Bankruptcy Code does not require the IRS to turn over such property. Pet. Br. at 22-23.

Since the relevant provisions of the Bankruptcy Code make no distinction between the IRS and other entities, this rationale would be equally applicable to any "entity" in possession of the debtor's property under a claim of right. *See*, 11 U.S.C. (Supp. IV) §542(a). A secured party who has repossessed property of the debtor prior to bankruptcy has the right to possession of its collateral under §9-503 of the Uniform Commercial Code,[6] just as the IRS, under §§6331(a) and 6332(a) of the Internal Revenue Code,[7] has the right to possession of property seized by tax levy. Under the theory urged by the government, it is the nature and extent of the debtor's non-bankruptcy interests in property that determines whether that property is subject to turnover. Since this theory holds that the existence or non-existence of a possessory interest in the debtor ultimately determines whether a particular item of property must be turned over, no meaningful distinction can be made between a possessory interest that has been forfeited to the IRS prior to bankruptcy by tax levy under the Internal Revenue Code, and a possessory interest that has been forfeited to a secured creditor by repossession under state commercial

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[6]UCC 9-503 provides, in relevant part, that "[u]nless otherwise agreed a secured party has on default the right to take possession of the collateral."

[7]Section 6331(a) of the Internal Revenue Code, 26 U.S.C. §6331(a), gives the Secretary of the Treasury the right to collect a delinquent tax "by levy upon all property and rights to property . . . belonging to" the taxpayer. The Internal Revenue Code defines "levy" as including "the power of distraint and seizure by any means". 26 U.S.C. §§6331(b); 7701(a)(21). Section 6332(a) of the Internal Revenue Code requires "any person in possession of . . . property or rights to property subject to levy upon which a levy has been made" to "surrender such property or rights" to the IRS on demand.

law.[8] It follows that if the government's construction of the relevant statutes is correct, the bankruptcy court would lack the power to displace from possession not only the IRS holding property seized by tax levy, but also a secured creditor holding collateral repossessed from the debtor[9] or a pledgee holding the debtor's pledge after default[10], regardless of the extent of the debtor's equity in such property.

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[8]The government points to several differences between private secured creditors and the tax collector, none of which alter this conclusion. The nonconsensual nature of a tax levy does not enlarge the IRS' right to possession of seized property; nor does the consensual nature of a secured transaction diminish the secured creditor's right to possession upon default. If anything, the fact that the IRS is entitled to levy upon all property belonging to the taxpayer, 26 U.S.C. §6331(a), while a secured creditor generally obtains a security interest in the collateral or classes of collateral specified in a security agreement, *See,* U.C.C. §9-203, suggests that the IRS' property interest in any particular item is less necessary of protection than a secured creditor's would be. In any event, the fact that the IRS has greater collection remedies available to it does not distinguish the government's right to possession of seized property from that of a secured creditor in possession of collateral following default.

[9]In fact, at least one court has already extended the rule of *Cross Electric Co. v. United States,* 664 F.2d 1218, *supra,* beyond the limited context of a tax levy. See, *In re Campbell,* 20 B.R. 42 (Bankr. D.S.C. 1982); In *Campbell,* the bankruptcy judge held that an automobile repossessed by a secured creditor prior to bankruptcy was not subject to turnover under §542(a). *Id.*

[10]"A pledge is a security interest in a chattel or in an intangible . . . created by a bailment for the purpose of securing the payment of a debt or the performance of some other duty." RESTATEMENT OF SECURITY §1 (1941). Under the Uniform Commercial Code, after default, the rights of a pledgee to the collateral are identical to those of a non-possessory secured party who has repossessed such collateral: *See,* ALI, UCC§9-501, Comment 2 (1978 Official Text with Comments). *See also,* U.C.C. §§9-501(1); 9-502, 9-504, 9-505.

C. *Cases Decided Under The Bankruptcy Act Which Denied Turnover Against The Internal Revenue Service Are Not Meaningful Precedent Under The Bankruptcy Code.*

Although private creditors may be subject to turnover under §542(a) of collateral acquired by them from the debtor pre-petition, the government here claims that it is excepted from such requirement either because the nature of an IRS levy has been judicially determined to transfer "ownership" of levied property to the government,[11] or because, in its view, existing law prior to the Bankruptcy Code did not require turnover by the government of property seized pre-petition by the IRS and no evidence exists that Congress intended to effect such a change in enacting the Bankruptcy Code.[12] Either argument takes its genesis from the decision of this Court in *Phelps v. United States*, 421 U.S. 330 (1975), as well as certain of the prior decisions cited therein.[13] Because of its preeminence as the primary cited authority in all of the post-Bankruptcy Code court decisions denying turnover versus the IRS, with the inexplicable exception of the Fourth Circuit's decision in *Cross Electric, supra*, it would not be amiss to characterize *Phelps* as the standard upon which the government has raised its flag to do battle with turnover. But are *Phelps* and the related pre-Code cases decided on its authority really relevant to issues raised under the Bankruptcy Code? We respectfully submit that the Court of Appeals below was correct in concluding that they were not.

In *Phelps*, the Court held that where an IRS levy had been made upon an assignee for benefit of creditors in possession of

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[11] e.g. "Thus, a levy virtually transfers ownership of seized property to the government" Pet. Br., at 25.

[12] Pet. Br. point C(2), at 32-36.

[13] *United States v. Eiland*, 223 F.2d 118 (4th Cir. 1955) *United States v. Pittman*, 449 F.2d 623 (7th Cir. 1971).

$38,000.00, as proceeds of the liquidation of a taxpayer's assets, in order to collect $140,831.59 in delinquent taxes, a bankruptcy receiver appointed under the former Bankruptcy Act, in an involuntary proceeding commenced after the levy, could not obtain a turnover of the $38,000.00 from the assignee for benefit of creditors over the opposition of the IRS. In so holding, the Court found that the IRS levy placed the funds in the "constructive possession" of the IRS although retained by the assignee. Having such pre-petition possession adversely held for the benefit of the government, "the holder [i.e. the assignee] is not subject to summary jurisdiction [of the Bankruptcy Court]" 421 U.S. 335-6, *quoting with approval* 2 J. Moore & R. Oglebay, *Collier on Bankruptcy* ¶23.06 [3], pp. 506.2-506.3 (14th ed. 1975).

Four salient facts existed in the *Phelps* case which had a substantial bearing not only upon the decision in the case but upon the language used by the court in its opinion. Those facts are:

1. The case was decided under the Bankruptcy Act of 1898, as amended.

2. The bankruptcy proceeding at issue was a "straight bankruptcy" or liquidation case.

3. The debt owed the government was more than 3-1/2 times the value of the fund in the hands of the assignee.

4. The collateral at issue consisted solely of money in the hands of the assignee.

The first two facts relate to the prior settled law that, in a liquidation case under the Bankruptcy Act, the jurisdiction of the bankruptcy court over assets of the bankrupt extended only to those in the actual or constructive possession of the bankrupt on the date of the petition. 2 *Collier on Bankruptcy* ¶23.04[2] (14th ed. 1976). Unless this limitation on its so-called summary jurisdiction were waived by such a party,[14] the bankruptcy

[14] In *Phelps* the court specifically found that no such waiver had been made by the IRS. 421 U.S. 336, n.6

court could not acquire jurisdiction over assets adversely held by a third party under claim of right. *Cline v. Kaplan*, 323 U.S. 97 (1944), see also 2 *Collier on Bankruptcy* ¶23.04[2] (14th ed. 1976).

Thus, where a mortgagee had commenced foreclosure in state court before the petition, the bankruptcy court in a liquidation case under the Act had no jurisdiction over the real property being foreclosed, nor did Bankruptcy Rule 601(a) (1) stay such a proceeding. 13 *Collier on Bankruptcy* ¶601.05[2-1.1] (14th ed. 1977).

This limitation of jurisdiction was in marked contrast to the jurisdiction of the bankruptcy court in a Chapter X, Chapter XI, or Chapter XII case under the Act where possession at the time of the petition was irrelevant to the court's jurisdiction which extended to the debtor's property "wherever located."[15] Although a turnover power was expressly granted to a trustee or debtor-in-possession in a Chapter X[16] or Chapter XII[17] case, the absence of a specific grant in Chapter XI[18] cases may

[15]Bankruptcy Act §§111 (Chapter X), 311 (Chapter XI), 411 (Chapter XII); Act of June 22, 1938, ch. 575, 52 Stat. 840 *et. seq.*, §§111, 311, 411; 11 U.S.C. §§511, 711, 811.

[16]Bankruptcy Act §257, Act of June 22, 1938, ch. 575, §1, 52 Stat. 902; 11 U.S.C. §657.

[17]Bankruptcy Act §507, Act of June 22, 1938, ch. 575, §1, 52 Stat. 927; 11 U.S.C. §907.

[18]The absence of a turnover provision comparable to §257 or §507 in Chapter XI of the Bankruptcy Act can be explained by the fact that an arrangement under Chapter XI could affect only the rights of unsecured creditors. The status of security holders was to remain unaltered. Bankruptcy Act §§306(1), 356, Act of June 22, 1938, ch. 575 §1, 52 Stat. 840, *et. seq.*, §§306(1), 356, 11 U.S.C. §§706(1), 756; *Securities & Exchange Comm'n. v. United States Realty & Improvement Co.*, 310 U.S. 434 (1940). As a creditor holding assets of the debtor at the time of the filing of a petition would not be unsecured, a turnover provision would have served no useful purpose as Chapter XI was not intended to affect that creditor's pre-petition status.

have been the deciding, although unexpressed, factor in the decision of the Third Circuit in *In re Pittsburgh Penguins Partners*, 598 F.2d 1299 (3d Cir. 1979) which, in following *Phelps*, held that a pre-petition tax levy divested the bankruptcy court, in a subsequent Chapter XI case, of summary jurisdiction over the funds levied upon.[19]

As the Court of Appeals below noted,[20] the distinction between summary jurisdiction and plenary jurisdiction, which was critical to the *Phelps* holding that the bankruptcy court in *Phelps* lacked *summary* jurisdiction over the fund at issue, no longer exists under the Bankruptcy Code, as Congress opted for a more expansive jurisdiction grant, 28 U.S.C. §1471(e), patterned upon §111 of Chapter X of the Bankruptcy Act. Most importantly, the Court of Appeals noted that *Phelps* did not decide that a bankruptcy court would not have had the power to order a turnover had *Phelps* been a Chapter X case rather than a straight bankruptcy case as no such restriction had ever been judicially imposed in any reported case under the reorganization provisions of §§77 and 77B, Chapter X or Chapter XII.[21] The generally expanded jurisdiction in the bankruptcy court under 28 U.S.C. §1471(e), when coupled with the broadly stated turnover power under §542(a),[22] clearly

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[19]Thus the funds were held to be subject to IRS claims for penalties and post-petition interest notwithstanding the fact that neither would be allowed the IRS as part of a claim in the Chapter XI case.

[20]Pet. App. at 25a.

[21]Pet. App. 26a, quoting 6 *Collier on Bankruptcy* §3.05 at 431 (14th ed. 1977). *United States v. Eiland* and *United States v. Pittman*, both noted *supra*, were straight bankruptcies, while *In re Pittsburgh Penguins Partners, supra*, was a Chapter XI case.

[22]Turnover applies to all "entities" under §542(a) and extends to all "property that the trustee may use, sell or lease" rather than just to "all property of the debtor in the possession of a trustee under a trust deed or a mortgagee under a mortgage." Bankruptcy Act §257, *supra* note 16.

justifies the Court of Appeals' conclusion that *Phelps* is not precedent for the facts in the present case.[23] As no pre-Code cases exist as precedent for the exercise by a reorganization court of a turnover power against the Internal Revenue Service, the Court of Appeals was entirely correct in searching for available precedent under the Bankruptcy Act and finding such precedent in *Reconstruction Finance Corporation v. Kaplan*, 185 F.2d 791 (1st Cir. 1950) and related cases. Such precedent is now made relevant to turnover against the government by virtue of §106(c) of the Bankruptcy Code which makes any Code provisions applicable to an "entity" applicable to the government, "notwithstanding any assertion of sovereign immunity." As §542(a) applies to any "entity", it applies to the IRS. Under the Bankruptcy Act, however, no general waiver of sovereign immunity existed, and it is at least questionable whether turnover could have been compelled at all against the IRS under §257.[24] Accordingly, Bankruptcy Act turnover cases brought against the IRS may be of little or no precedential use at all under the Code.

Of the four salient facts in *Phelps* previously referred to, we have demonstrated our belief that the fact that *Phelps* arose under the Bankruptcy Act and the fact that it was a liquidation case makes *Phelps* irrelevant as precedent in this case. Under this analysis, we believe the Court of Appeals concluded correctly that the government was reduced to the argument that an IRS levy effects a transfer of ownership to the government

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[23] In so concluding, the court stated: "It is plain that the holding in *Phelps* does not assist the Government here." (Pet. App. 25a).

[24] cf. *In re American Boiler Works, Inc.*, 123 F. Supp. 352 (W.D.Pa. 1954), *aff'd.*, 220 F.2d 319 (3d Cir. 1955) which held that the absence of a specific reference to the United States in §70(e) of the Bankruptcy Act prevented the use of that section by a trustee to avoid a transfer made to the government by the bankrupt.

of the property seized, not just a transfer of possession.[25] The government makes it clear in its own brief that it bases its position on a claim of ownership.[26] The primary source of such a claim is two oft-quoted statements in *Phelps*, that the tax levy gave the United States "full legal right"[27] to the property levied upon and that "the pre-bankruptcy levy displaced any title of (the taxpayer)."[28]

We believe and respectfully submit that these statements of the court must be read in light of the third and fourth salient facts in *Phelps* previously referred to, i.e. that the debt owed IRS substantially exceeded the amount levied upon and that the collateral seized was money in the hands of a third party. In this respect the facts in *Phelps* are identical to the facts in *United States v. Eiland*,[29] *supra*, and even to those in *Cross Electric Company, Inc. v. United States, supra*.[30]

Had the property seized by IRS in *Phelps, Eiland,* or *Cross Electric* been tangible assets, rather than cash or a cash equivalent, there is no question but that the full panoply of procedures mandated by §6335 of the Internal Revenue Code of 1954 would have had to have been followed by IRS before a fund could be created from which the delinquent taxes could be

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[25]Pet. App. at 26a.

[26]Pet. Brief, at 25-26.

[27]421 U.S. 330, 337

[28]421 U.S. 330, 337 n.8

[29]$1,884.54 account receivable seized to satisfy IRS debt of $7,172.42.

[30]$5,672.65 account receivable seized to satisfy IRS debt of $43,297.15.

paid.[31] In such an event, it is clear that title to the seized property could not have passed to the government by the mere act of seizure under levy, for the Internal Revenue Code itself requires not only the conduct of an actual sale by public auction or by public sale under sealed bid,[32] it further directs the delivery of a certificate of sale to the purchaser[33] and, in addition, the delivery of a deed if the property sold is real property.[34] The certificate of sale acts as the conveyance document of the interest of the delinquent taxpayer in the property sold, if other than real property,[35] but the deed is the instrument of such conveyance if real property is sold.[36] The delivery of a deed to the United States is also mandated if the government is declared the purchaser of real property.[37]

Moreover, the fact that the taxes owed in *Phelps* exceeded the proceeds seized cannot be overlooked. Had the proceeds exceeded the taxes, it is inconceivable that the Court would have found the government to have "full legal right" to the entire proceeds or the bankrupt's title to be totally "displaced". It is similarly inconceivable that the holding in *Cross Electric* would not have changed had the tax owed been $5,672.65 rather than

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[31] Such procedures include: giving the "owner" notice of seizure §6335(a), giving the "owner" notice of sale §6335(b), fixing a time and place of sale within mandatory guidelines §6335(d), establishing a minimum price §6335(e)(1), prescribing the manner and conditions of sale §6335(e)(2), and reconducting the sale under certain conditions §6335(e)(3).

[32] Internal Revenue Code of 1954 §6335(e)(2)(a).

[33] Internal Revenue Code of 1954 §6338(a).

[34] Internal Revenue Code of 1954 §6338(b).

[35] Internal Revenue Code of 1954 §6339(a)(2).

[36] Internal Revenue Code of 1954 §6339(b)(2).

[37] Internal Revenue Code of 1954 §6338(c).

$43,297.15 and the levied upon account receivable $43,297.15, rather than $5,672.65.

Language to the effect, then, that a seizure under levy transfers "full legal right"[38] to the property, "displaces any title"[39] of the taxpayer, or is "tantamount to a transferal of ownership"[40] to the government can only be understood in the context of the seizure of incorporeal property having a value not in excess of the taxes owed, unlike the inventory, equipment and other tangible property seized from Whiting in this case.[41] Indeed, where the property seized is cash or a debt owed the taxpayer, upon the delivery of the property to it by the third party against whom the levy was made, the government would merely apply the property seized in reduction of the tax debt, the sale procedures of I.R.C. §6335 being unnecessary to reduce the property to cash. As the court in *Phelps* held the assignee for benefit of creditors to be a "custodian for the United States"[42] without personal interest in the proceeds, the possession of the proceeds by the assignee rather than the

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38 *Phelps v United States*, 421 U.S. 330, 337.

39 *Phelps v. United States*, 421 U.S. 330, 337 n.8.

40 *United States v. Sullivan*, 333 F.2d 100, 116 (3d Cir. 1964) involving the seizure of contract rights (cash surrender values) under life insurance policies.

41 Pet. Brief, Statement, p.2; Pet. App. 2a. Although the government asserts that the value of the property seized was only $35,000.00 (Pet. Brief, p. 25 n.15), that was the amount that the bankruptcy court found might be realized by the IRS on a distress sale (Pet. App. 36a), a fact relevant only to the issue of adequate protection. The bankruptcy court further found the going concern value of the property to be $162,876.00, an amount substantially in excess of the delinquent taxes. (Pet. App. 35a).

42 421 U.S. 330, 333. This custodial relationship was sufficient for the Court to find that the United States was in "adverse possession" of the proceeds, thus defeating the bankruptcy court's summary jurisdiction over the proceeds.

government would have been immaterial to the legal rights of the government in the proceeds under the law as it then existed. Whether this would continue to be true in a case arising on the *Phelps* facts under the Bankruptcy Code is less clear. It is possible that the assignee for benefit of creditors would be held to be a "custodian" subject to turnover under Bankruptcy Code §543.[43]

As we have shown, then, *Phelps* and the other pre-Bankruptcy Code decisions on IRS turnover to trustees or receivers are not of precedential value in interpreting turnover under the Code, nor is the "ownership" language in such cases applicable to the facts in the present case.

D. *The Court Of Appeals Properly Rejected The Government's Strained And Over Literal Construction Of §§542(a), 541(a) (1) And 363 Of The Bankruptcy Code.*

The government argues that the "plain meaning" of the relevant statutory language dictates that the "property of the estate" subject to turnover consists solely of the debtor's interest in property as of the commencement of the case. Pet. Br. at 19, 39-40. In our view, the Court of Appeals was justified in rejecting the government's over literal and formalistic construction in favor of a construction consistent with the purposes and policies of the Bankruptcy Code.

The starting point in statutory construction must, of course, be the language employed by Congress. e.g., *Reiter v. Sonotone Corp.*, 442 U.S. 330, 337 (1979). Under the "plain meaning" rule of statutory construction, where the language is

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[43]A "Custodian" is required by §543(b)(1) to "deliver to the trustee any property of the debtor transferred to such custodian, or proceeds of such property, that is in such custodian's possession, custody or control . . . ." the bankruptcy court below found the IRS in this case to be a "custodian" and directed turnover under §543. (Pet. App. 41a). Both the District Court (Pet. App. 10a) and the Court of Appeals (Pet. App. 10a) disagreed with the bankruptcy court on this point.

clear and a literal construction produces a reasonable result consistent with the legislative intent, the court will not look beyond the language to extrinsic sources. See, e.g., *American Tobacco Co. v Patterson*, ___ U.S. ___ 102 S.Ct. 1534, 1537 (1982); *Consumer Product Safety Comm'n v. GTE Sylvania Inc.*, 447 U.S. 102, 108 (1980). But the plain meaning rule is "rather an axiom of experience than a rule of law," *Boston Sand Co. v. United States*, 278 U.S. 41, 48 (1928), and, as such, does not bar a court from looking beyond the superficial meaning of words in a statute to a consideration of the circumstances of the particular enactment. See, *Watt v. Alaska*, 451 U.S. 259, 266 (1981); *Train v. Colorado Public Interest Research Group*, 426 U.S. 1, 10 (1976); *United States v. American Trucking Assns.*, 310 U.S. 534, 543-544 (1940).

> When aid to construction of the meaning of words as used in a statute, is available, there certainly can be no "rule of law" which forbids its use, however clear the words may appeal on "superficial examination" . . . . Obviously there is danger that the court's conclusion as to legislative purpose will be unconsciously influenced by the judges' own views or by factors not considered by the enacting body. A lively appreciation of the danger is the best assurance of escape from its threat, but hardly justifies an acceptance of a literal interpretation dogma which withholds from the courts available information for reading a correct conclusion. A few words of general connotation appearing in the text of statutes should not be given a wide meaning, contrary to a settled policy, "excepting as a different purpose is plainly shown." (footnotes omitted).

Id., at 543-544; *quoted in United States v. Security Industrial Bank*, ___ U.S. ___, 103 S.Ct. 407, 414 n.12 (1982).

As a preliminary matter, the government's argument that the "plain meaning" of the relevant statutes conflicts with the Second Circuit's construction suffers from an inherent ambiguity in the pivotal phrase "property of the estate", as

employed in §363 of the Bankruptcy Code. The ambiguity derives from the fact that the drafters of §363 plainly envisioned both the existence of other parties with interests in the "property of the estate", *see*, 11 U.S.C. (Supp. IV) §363(a), (e), (f), and the *use*, by the trustee or debtor-in-possession, of encumbered property, *see*, 11 U.S.C. (Supp. IV) §363(c); H.R. Rep. No. 95-595, 95th Cong., 1st Sess., 181-182, 344-345 (1977); S. Rep. No. 95-989, 95th Cong., 2d Sess., 5, 55-56 (1978).[44] Thus it appears that the reference is to *items of property* capable of use and capable of being encumbered, rather than to the debtor's *interests in property*. Yet, as the government contends, the phrase "property of the estate", as employed in §541(a) (1) of the Bankruptcy Code is a defined term meaning "all legal or equitable interests of the debtor in property as of the commencement of the case." This ambiguity renders the plain meaning rule inapposite and itself justifies reference to the legislative history for clarification.

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[44]For example, the House Report, H.R. Rep. No. 95-595, *supra*, at 181, states that:

> H.R. 8200 sets out in detail the rights of a trustee or a debtor in possession to use, sell, or lease property of the estate in the operation of the debtor's business in a reorganization case or in a winding-up operation in a liquidation case. These provisions are not found in the current Bankruptcy Act, but are governed by spotty case law. *The issue becomes most difficult when the property being used is collateral for a loan to the debtor. Then it is necessary to insure that the interest that the secured creditor has in the property is protected*, and that no erosion forbidden by the Constitution takes place. H.R. 8200 brings together the rules governing the use of such property, and provides protection for both the debtor, in the operation of the business, *and the secured creditor, in his interest in the property used.*
> (Emphasis added, footnotes omitted).

Both the House and Senate Reports, H.R. Rep. No. 95-595, *supra*, at 344; S.Rep. No. 95-989, *supra*, at 55, describe the purpose of §363 as follows:

> This section defines the right and powers of the trustee with respect to the use, sale, or lease of property *and the rights of other parties that have interests in the property involved.*

Even if this key language were not ambiguous, the plain meaning rule would have no application here. Where the plain meaning of the statutory language yields either absurd results, see, e.g. *United States v. Bryan*, 339 U.S. 323, 338 (1950); *Armstrong Co. v. Nu-Enamel Corp.*, 305 U.S. 315, 333 (1938); *United States v. Kirby*, 74 U.S. [7 Wall.] 482, 486 (1869), or an unreasonable result "plainly at variance with the policy of the legislation as a whole", *Ozawa v. United States*, 260 U.S. 178, 194 (1922), the reviewing court will look to the purposes and policies of the statute as revealed by the legislative history rather than slavishly adhere to the literal import of the words. *See, e.g., United Steelworkers of America vs. Weber*, 443 U.S. 193, 201-202 (1979); *United States v. American Trucking Assns.*, 310 U.S. 534, 543, *supra; Helvering v. Hammel*, 311 U.S. 504, 510-511 (1941). Reference to the purposes and policies of the Bankruptcy Code is particularly appropriate, since the courts construing the predecessors to the Code have traditionally eschewed "narrow formalistic interpretations which disregard the spirit and letter of the [statute]", *Wright v. Union Central Life Ins. Co.*, 311 U.S. 273, 279 (1940), in favor of a construction which effectuates the general remedial purpose and policy of the bankruptcy statute. *See, e.g., Local Loan Co. v. Hunt*, 292 U.S. 234, 244-245 (1934); *Lines v. Frederick*, 400 U.S. 18, 19-20 (1970); *Segal v. Rochelle*, 382 U.S. 375, 379 (1966); *Wright v. Union Central Life Ins. Co., supra*, at 279; *Maynard v. Elliott*, 283 U.S. 273, 277 (1930); *Williams v. United States Fidelity & Guaranty Co.*, 236 U.S. 549, 554-555 (1915).

Here, the government's analysis yields an absurd and unreasonable result that conflicts with various policies of the Code. The government proceeds by inserting the §541(a) "definition" of "property of the estate" into §363 and, ultimately, into §542(a). Using this analysis, the government concludes that only the debtor's *interests in property* as they exist on the date the petition is filed are subject to turnover

under §542(a) of the Bankruptcy Code. Pet. Br. at 14-19. It follows from this analysis that §542(a) of the Bankruptcy Code would literally require an entity "in possession, custody or control" (11 U.S.C. (Supp. IV) §542(a)) of "legal or equitable interests of the debtor in property" (11 U.S.C. (Supp. IV) §541(a) (1)) to deliver those *interests* to the trustee. The government fails to explain, however, how a debtor's *interest* in property could be in the "possession, custody or control" of a third party, how "delivery" of an *interest* could be accomplished, or why the trustee would need the turnover power to bring property *interests* into the bankruptcy estate, when that is already accomplished by §541(a) (1) of the Bankruptcy Code. Since the government must concede that the turnover power is intended as a mechanism for the physical recovery of items of property in the hands of third parties,[45] the result yielded by the government's analysis is both strained and absurd.

As will be discussed more fully in subsequent portions of this brief, the result yielded by the government's strained construction fundamentally conflicts with the rehabilitative purpose of the reorganization chapter of the Code by depriving the debtor-in-possession of the use of any property which has been repossessed by a secured creditor or levied upon by the government, without regard to the debtor's equity in that property, or the impact on reorganization. Where, as here, virtually all the assets of the debtor have been seized prior to bankruptcy, the inevitable result of such a rule will be the failure of reorganization and the cessation of the business.

The view of the statutes taken by the Court of Appeals, by contrast, would promote reorganization while protecting the interests of the secured creditor in its collateral through the concept of adequate protection. *See,* 11 U.S.C. (Supp. IV)

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[45]Thus, the very title of Section 542 reads: "Turnover of property to the estate."

§§361, 363(b), (c) (1). The government's analysis reads adequate protection out of the Code, thereby ignoring the interrelationship between §363 and §542(a). No satisfactory explanation is offered by the government's analysis for the fact that §542(a) cross-references to property that may be used, sold or leased under §363, rather than directly to the definition of "property of the estate" in §541(a). The logical answer is that Congress intended that the turnover authority, like the power to use, lease and sell property of the debtor, would be limited by the concept of adequate protection. *See, e.g.*, 4 *Collier on Bankruptcy* ¶542.02 (15th ed. 1982). It follows, therefore, that Congress contemplated that the turnover power would be used to recover property in which a creditor retained an interest warranting adequate protection. While the Second Circuit's view of the statute takes adequate protection into account, the government's view turns solely on the debtor's non-bankruptcy right to possession of property, and would deny turnover whether or not the repossessing creditor's interest could be adequately protected. Thus, the government's analysis violates the admonition that all parts of a statute should be construed together so as to produce a harmonious whole. *See*, C. Sands, 2A *Sutherland on Statutes and Statutory Construction*, §46.05 (4th ed. 1973).

E. *The Legislative History Compels The Conclusion That §542(a) Of The Bankruptcy Code Was Intended By Congress As a Codification Of the Broad Turnover Power Existing In Chapters X And XII Of The Bankruptcy Act.*

Having correctly discerned that the government's construction of the statutory scheme "would have a far-reaching effect on reorganizations by denying to debtors and trustees in reorganization not only the power to obtain the turnover of property of the debtor levied upon by the IRS, but also that repossessed prior to bankruptcy by secured creditors or held by pledgees after a default", *United States v. Whiting Pools, Inc.*,

674 F.2d 144, 150, *supra;* Pet. App. at 12a-13a, the Second Circuit next considered whether such a drastic result is compatible with the intent of Congress as revealed in the legislative history of §542(a), *Id.*, at 150-156; Pet. App. at 13a-23a. Placing primary reliance on the derivation of §542(a) during the legislative process, as clarified by the statements of various witnesses at the legislative subcommittee hearings, the Court of Appeals concluded that §542(a) was intended to give a bankruptcy court in a reorganization proceeding under Chapter 11 of the Bankruptcy Code the same broad turnover power available in reorganization proceedings under Chapter X and XII of the former Bankruptcy Act of 1898, *Id.*

The fundamental problem facing the Second Circuit in its attempt to ascertain the congressional intent from the legislative history of §542(a) was the absence of an unequivocal statement in either the House or Senate Committee Reports or in the Floor debates concerning the power of the bankruptcy court to order turnover of property that had been repossessed by a secured creditor before bankruptcy. Thus, for example, in their discussion of §542, the House and Senate Reports merely state that:

> Subsection (a) of this section requires anyone *holding property of the estate* on the date of the filing of the petition, or property that the trustee may use, sell or lease under section 363, to deliver it to the trustee . . . . The *holder of the property of the estate* is excused from the turnover requirement of this subsection if *the property held* is of inconsequential value to the estate. (Emphasis added).

H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 369 (1977); S. Rep. No. 95-989, 95th Cong., 2d Sess. 84 (1978).[46] This

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[46]Similarly, during the final debates on the Compromise Bill, H.R. 8200, the floor managers of the House and the Senate each described the purpose of Section 542(a) in terms which merely track the statutory language:

Footnote continued on next page—

statement is susceptible to two variant interpretations depending on whether the words "property of the estate" are intended to refer to items of property in which the bankruptcy estate has an interest or to those interests themselves. Because of this inherent ambiguity, this and similar statements in the legislative history provide little actual guidance as to the intended scope of the turnover power.

The clearest statement of congressional intent regarding the scope of §542(a) appears in the discussion in the House and Senate Committee Reports of the kinds of property that become property of the estate under §541(a)(1), where it is written that:

> The scope of this paragraph is broad. It includes all kinds of property, including tangible or intangible property, causes of action (see Bankruptcy Act §70a(6)), and all other forms of property currently specified in section 70a of the Bankruptcy Act §70a, *as well as property recovered by the trustee under section 542 of proposed title 11, if the property recovered was merely out of the possession of the debtor, yet remained "property of the debtor."* The debtor's interest in property also includes "title" to property, which is an interest, just as are a possessory interest, or leasehold interest, for example. (emphasis added).

H.R. Rep. No. 95-595, *supra*, at 367. S. Rep. No. 95-985, *supra* at 82. The authors of this passage treated turnover under §542(a) as an independent bankruptcy power rather than as a mere adjunct to §541(a)(1). This strongly suggests that items of

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—Footnote continued from preceding page

> The section makes clear that any entity, other than a custodian, is required to deliver property of the estate to the trustee or debtor in possession whenever such property is acquired by the entity during the case, if the trustee or debtor in possession may use, sell, or lease the property under section 363, or if the debtor may exempt the property under section 522, unless the property is of inconsequential value or benefit to the estate.

124 Cong. Rec. 32399-32400 (1978) (Statement of Rep. Edwards); 124 Cong. Rec. 33999 (1978) (Statement of Sen. DeConcini).

property out of the possession of the debtor may be brought into the bankruptcy estate by exercise of the turnover power if the debtor retained a non-possessory interest in those items of property. The reference to property recovered under §542 would be totally superfluous if all that could be recovered by turnover was the debtor's possessory interests, since the passage makes it clear that such possessory interests are brought directly into the bankruptcy estate by §541(a)(1).

While the above statement from the House and Senate Committee Reports supports an inference that Congress intended that the turnover power could reach "property of the debtor" in the rightful possession of third parties, it makes no explicit mention of secured creditors and thus cannot be considered conclusive.

Having found no conclusive statements of congressional intent in the committee reports or legislative debates, the Court of Appeals considered the genesis of §542(a) during the legislative process.[47] *United States v. Whiting Pools, Inc.*, 674

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[47]Given the inconclusiveness of the committee reports and legislative debates, the Court of Appeals was plainly justified in looking to the congressional hearings for guidance. See, e.g. *Dawson Chemical Co. v. Rohm & Haas Co.*, 448 U.S. 176, 202-213, *rehearing den.*, 448 U.S. 917 (1980); *Corning Glass Works v. Brennan*, 417, U.S. 188, 198-201 (1974); *United States v. American Trucking Assns.*, 310 U.S. 534, 548-549 (1940); See generally, C. Sands, *Sutherland on Statutes and Statutory Construction* §48.10, at 209-210 (4th ed. 1973). Just as there is no rule of law which forbids a court from recourse to available extrinsic aids in construing a statute, e.g., *United States v. American Trucking Assns., supra*, at 543-544, there is no rule of law which would require a court to give absolute priority to inconclusive statements and generalizations in committee reports or legislative debates over other extrinsic aids, compare *Corning Glass Works v. Brennan, supra*, with *United States v. International Union, United Automobile Workers*, 352 U.S. 567, 585 (1957). To paraphrase Justice Marshall in *Corning Glass Works v. Brennan, supra* at 198:

> "[I]n this case, a better understanding of [the language of Section 542(a)] can be obtained from a consideration of the way in which Congress arrived at the statutory language than from trying to reconcile or establish preferences between the conflicting interpretations of the [Code] by individual legislators or the committee reports."

F.2d 144, 152-153, *supra;* Pet. App. at 17a-18a. Neither §542(a), nor any comparable turnover provision, appeared in either the bankruptcy legislation proposed by the Commission on the Bankruptcy Laws of the United States, H.R. 31, 94th Cong., 1st Sess. (1975); S. 236, 94th Cong., 1st Sess. (1975) or the competing proposal of the National Conference of Bankruptcy Judges, H.R. 32, 94th Cong., 1st Sess. (1975); S. 235, 94th Cong., 1st Sess. (1975).[48] §542(a) first appeared in H.R. 6, 95th Cong., 1st Sess. (1977), a bill drafted by the staff of the Subcommittee on Civil and Constitutional Rights of the House Judiciary Committee following extensive subcommittee hearings on H.R. 31 and H.R. 32[49] and intensive consultations with bankruptcy experts from the National Bankruptcy Conference and the National Conference of Bankruptcy Judges, 123 Cong. Rec. 35448 (1977) (Remarks of Rep. Butler);

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[48]The legislative process which culminated in the enactment of the Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549, began with the introduction in 1973 of legislation proposed in the REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. Doc. 93-137, 93d Cong., 1st Sess. (1973), as H.R. 10792, 93d Cong., 1st Sess. (1973), and S. 4026, 93d Cong., 1st Sess. (1973). See Klee, *Legislative History of the New Bankruptcy Code,* 54 Am. Bankr. L.J., 275, 277-278 (1980). This proposed legislation was reintroduced in the 94th Congress as H.R. 31 and S.236. *Id.* at 278-279. A competing bill proposed by the National Conference of Bankruptcy Judges was introduced in 1974 as H.R. 16643, 93d Cong., 2d Sess. (1974), and reintroduced in 1975 as H.R. 32 and S. 235.

These early drafts each contained turnover provisions comparable to §543 of the Bankruptcy Code, which were limited to property in possession of "custodians". H.R. 31, S .236, §4-603; H.R. 32, S. 235 §4-603.

[49]Thirty-five days of hearings were held before the House subcommittee between May of 1975 and May of 1976. *Hearings on H.R. 31 & H.R. 32 Before the Subcomm. on Civil & Constitutional Rights of the House Comm. on the Judiciary,* 94th Cong., 1st & 2d Sess. (1975-1976). The corresponding Senate Subcommittee also held twenty-one days of hearings on S. 235 and S. 236 between February and November of 1975. *Hearings on S. 235 & 236 Before the Subcomm. on Improvements in Judicial Machinery of the Senate Comm. on the Judiciary,* 94th Cong., 1st Sess. (1975).

Klee, *supra,* note 12, at 280. *See generally,* H.R. Rep. No. 95-595, *supra,* at 2-3. The language of Subsection (a) of §542 was incorporated into H.R. 6 in its present form, and no subsequent amendments were made during the legislative process. Thus, the Court of Appeals below, perceiving that the drafters of H.R. 6 had the benefit of the hearing transcripts in resolving the problems that had been identified at the hearings and elsewhere, found this chronology to be highly significant. *United States v. Whiting Pools, Inc.*, 674 F.2d 144, 153, 155; Pet. App. at 18a, 22a-23a. Based on this chronology, Judge Friendly reviewed the hearing transcripts for statements concerning the turnover power. *Id.* at 153; Pet. App. at 18a.

The hearing transcripts proved quite illuminating. Each of the witnesses who addressed the subject of turnover of collateral from secured creditors pointed out to the subcommittee that neither H.R. 31 nor H.R. 32 contained an express statutory grant of turnover authority that could compel the surrender of repossessed collateral by a secured creditor, and each recommended redrafting to rectify this oversight. See, *Hearings on H.R. 31 & H.R. 32 Before the Subcomm. on Civil & Constitutional Rights of the House Comm. on the Judiciary,* 94th Cong., 1st Sess., Part 1 at 439 (1975) (Prepared statement of Patrick A. Murphy, Esq.); *Hearings on H.R. 31 & H.R. 32, supra,* 94th Cong., 1st & 2d Sess., Part 2 at 1023 (1976) (Prepared statement of Walter W. Vaughan on Behalf of American Bankers' Assn. and the Consumer Bankers' Assn.); *Hearings on H.R. 31 & H.R. 32, supra,* 94th Cong., 2d Sess., Part 3 at 1757 (testimony of Robert J. Grimmig on Behalf of American Bankers' Assn.); *Id.*, at 1838 (Prepared statement of Leon S. Forman on Behalf of the National Bankruptcy Conference). There was a consensus among these witnesses that the turnover power present in reorganization cases under Chapters X and XII of the Bankruptcy Act should, given the expanded jurisdiction of the bankruptcy under the proposed bills, be extended at least to reorganization courts under the

new statute.[50] See, e.g. *Id.*, at 1756-1757; 1838. The National Bankruptcy Conference (NBC), whose opinion should be accorded especial weight in light of the direct participation of NBC representatives in the drafting of H.R. 6, see 123 Cong. Rec. 35448 (1977), recommended that "the right to gain possession from a secured creditor should exist in both liquidation and reorganization cases" and offered a proposed amendment to §4-603 of H.R. 31 and H.R. 32 which would have made that provision applicable to both custodians and "creditors".[51] *Hearings on H.R. 31 and H.R. 32,* 94th Cong., 2d Sess., Part 3 at 1838-1839.

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[50]Thus, for example, Patrick A. Murphy testified that the standard for turnover under the new consolidated reorganization chapter should be that "the jurisdiction of the bankruptcy court extends to property of the estate 'wherever located' without regard to whether it has been taken possession of by a secured creditor." *Hearings on H.R. 31 & 32,* 94th Cong., 1st Sess., Part 1 at 488. Explaining his reasons for advocating an express turnover authority applicable in reorganization cases, Murphy testified that:

> "In any chapter proceeding, that is in any rehabilitative proceeding, I can accept the need both for a stay over the collateral without regard as to who has possession and for, in appropriate circumstances, court authority to order the surrender for use in the rehabilitative process. I recognize that the latter power, which is present in at least Chapter X and XII of the existing law, should be exercised only in the most careful manner and after express findings by the court that no harm to the creditor will result by reason of the turnover of the property. I think it is vital that this power exist in the court because this is one of the examples of the advantage creditors may obtain in the weeks prior to bankruptcy by repossession or the appointment of a receiver with respect to collateral."

Id. at 489.

[51]The government discounts the input of the National Bankruptcy Conference on the ground that Congress did not adopt the proposed amendment to §4-603 of H.R. 31. Pet. Br. at 43. This ignores the fact that the substance of the NBC proposal suddenly appeared in H.R. 6 as a new turnover statute, Section 542(a). Although Congress did not adopt the specific language proposed by the NBC and did not choose to create one omnibus turnover provision, that does not destroy the inference that Section 542(a) was promulgated in response to recommendations made by the NBC witnesses and other at the House Hearings.

The fact that every witness to address the question of the scope of the turnover power recommended to the subcommittee that the proposed bankruptcy legislation be amended to explicitly incorporate the broad turnover power then existing under Chapter X, see, e.g., *Reconstruction Finance Corp. v. Kaplan*, 185 F.2d 791 (1st Dir. 1950), and Chapter XII of the Bankruptcy Act, see, e.g., *In Re Colonial Realty Investment Co.*, 516 F.2d 154 (1st Cir. 1975),[52] combined with the sudden appearance of a totally new turnover provision, §542(a), in the draft prepared immediately after those hearings[53] gives rise to a strong inference that §542(a) was intended to codify the broad turnover power universally advocated by those witnesses. No alternative explanation of the origin of §542(a) of the

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[52]One of the witnesses, Patrick A. Murphy, was also the author of an article critical of the proposed legislation's failure to expressly deal with the power of the bankruptcy court to recover property from secured creditors in possession. See, Murphy, *Use of Collateral in Business Rehabilitation: At Suggested Redrafting, of Section 7-203 of the Bankruptcy Reform Act*, 63 Calif. L. Rev. 1483, 1497-1498 (1975). This article was made a part of the hearing record, *Hearings on H.R. 31 and H.R. 32, supra*, 94th Cong., 2d. Sess., Part 3 at 1775, as were other articles reviewing the case law concerning the use and turnover of a secured party's collateral (including *Reconstruction Finance, supra*). See Coogan, Broude & Glatt, *Comments on Some Reorganization Provisions of the Pending Bankruptcy Bills*, 30 Bus. Law. 1149, 1169-1178 (1975), *reprinted in, Hearings on H.R. 31 & H.R. 32, supra*, 94th Cong., 1st Sess., Part 1, at 398; Murphy, *Restraint and Reimbursement: The Secured Creditor in Reorganization and Arrangement Proceedings*, 30 Bus. Law. 14, (1974) *reprinted in, Hearings on H.R. 31 & H.R. 32, supra*, 94th Cong., 1st Sess., Part 1, at 442.

[53]The House hearings were completed in May of 1976 and drafting of H.R. 6 began one month later. 23 Cong. Rec. 35448 (1977). On October 1, 1976, a preliminary draft was sent to the National Bankruptcy Conference and the National Conference of Bankruptcy Judges for review and comment. *Id.* From November to December of ;976, representatives of those two groups met extensively with congressional staff members to discuss the form the new draft should take. *Id.* In all, 13 full days of meetings were held. *Id.* The final version of H.R. 6 was introduced in the House of Representatives on January 4, 1977. *Id.*

Bankruptcy Code is offered by the government.[54] Thus, as the Court of Appeals found, the circumstances under which §542 was drafted compel "the inference that §542 was added to the Code to make clear — as a number of witnesses had explicitly urged — that the turnover power approved in *RFC v. Kaplan* was to be incorporated in the new statute."[55] *United States v. Whiting Pools, Inc.*, 674 F.2d 144, *supra*, at 155; Pet. App. at 23a.

Nevertheless, the government asserts that the legislative history supports a narrow view of the turnover power, relying primarily on general statements to the effect that §541(a)(1) "is not intended to expand the debtor's rights against others more than they exist at the commencement of the case", H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 369 (1977); S. Rep. No. 95-989, 95th Cong., 2nd Sess. 92 (1978), that "[i]f the debtor holds

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[54]The government speculates, without any support from the legislative history, that Section 542(a) is intended as a "general enforcement provision" codifying the judicially-created summary turnover procedure that existed under prior law, see *Maggio v. Zeitz*, 333 U.S. 56, 61-63 (1948). Pet. Br. at 44-45. Why Congress would suddenly deem it necessary to independently codify a turnover power implicit in the power of the bankruptcy court to issue orders necessary or appropriate to carry out the purposes of the Bankruptcy Code, see, 11 U.S.C. (Supp. IV) §105(a); 28 U.S.C. §1651 (All Writs Statute); *Maggio v. Zeitz, supra*, at 62, does not appear.

[55]This broad view of turnover under §542(a) is shared by commentators on the new Bankruptcy Code. See, 1 *Collier on Bankruptcy*, ¶3.01, at 3-56 (15th ed. 1982); Levit, *Use and Disposition of Property Under Chapter 11 of the Bankruptcy Code: Some Practical Concerns*, 53 Am. Bankr. L.J. 275, 283, n. 21 (1979); Moller & Foltz, *Chapter 11 of the Bankruptcy Code*, 58 N. Carolina L. Rev. 881, 902-903 (1980); Nowak, *Turnover Following Prepetition Levy of Distraint Under Bankruptcy Code §542*, 55 Am. Bankr. L.J. 313, 331-336 (1981); Orr & Klee, *Secured Creditors Under the New Bankruptcy Code*, 11 U.C.C. Law J. 312, 327-331 (1979); Reiley, *Secured Creditors and the Bankruptcy Act of 1978*, 14 U.S.F. L. Rev. 341, 352-353 (1980); Comment, *Bankruptcy and Turnover Proceedings Against the IRS: A Path Toward Reorganization and Rehabilitation Fraught with Pitfalls*, 4, Whittier L. Rev. 87, 122-124 (1982).

bare legal title or holds property in trust for another, only those rights which the debtor would have otherwise had emanating from such interest pass to the estate under Section 541", 124 Cong. Rec. 32399, 33999 (1978), and that "[t]o the extent such an interest is limited in the hands of the debtor it is equally limited in the hands of the estate. . . .", 124 Cong. Rec. 32399.

While the principle that the non-bankruptcy property rights acquired by the bankruptcy estate are generally limited to those held by the debtor at the commencement of the case is unassailable, neither that principle nor its various articulations in the legislative history are entitled to the controlling weight urged by the government.[56] Both the principle and the above statements relate to the composition of the bankruptcy estate under §541 of the Bankruptcy Code, not to the power of the bankruptcy court to displace a creditor in possession of property of the debtor and direct turnover pursuant to 11 U.S.C. (Supp. IV) §542(a). While it is true that the *non-*

[56]For example, the government points out that Congress deleted from the final legislation two proposed provisions, S.2266, 95th Cong., 2d Sess. §541(b)(1), (2) (1978), which would, respectively, have excluded from "property of the estate" property held by the debtor in trust for another and withholding taxes. 124 Cong. Rec. 32417, 34016-34017 (1978). The explanation given by the conference managers for the deletion was that these provisions were "unnecessary since property of the estate does not include the beneficial interest in property held by the debtor as a trustee." *Id.*

It is conceded that property held by the debtor as trustee, including "trust fund" taxes, *see*, 26 U.S.C. §7501, would not be property of the estate subject to turnover. Had the government established by tracing, *see, e.g., Slodov v. United States*, 436 U.S. 238, 256; *In re Rohar Associates*, 375 F. Supp. 637, 638-639 (S.D.N.Y. 1974); 4 *Collier on Bankruptcy*, ¶541.13 (15th ed. 1982); 2 G. Palmer *Restitution* §§2.14-19 (1978), that the assets seized by tax levy were the proceeds of trust funds, it would have had a defense to turnover. The government neither raised such a defense in the bankruptcy court, nor offered any proof that the tangible assets seized were traceable as the proceeds of "trust fund" taxes. Thus, the government's "trust fund" argument is irrelevant to this appeal, except as some support for the general principle that the bankruptcy estate does not acquire greater non-bankruptcy property rights than the debtor had.

possessory property interests of the debtor are not expanded upon inclusion in the bankruptcy estate, §542(a) provides an independent statutory grant to the bankruptcy trustee of a greater possessory right in bankruptcy than was held by the debtor prior to bankruptcy.

F. *A Construction Of Section 542(a) Which Would Deny The Bankruptcy Court The Power To Order Turnover Of Collateral In The Possession Of Secured Creditors And Property Seized By IRS Tax Levy Conflicts With The Policies Of The Bankruptcy Code, Particularly The Policy Favoring Successful Rehabilitation Of Business Debtors.*

Further support for the Second Circuit's conclusion that Congress intended §542(a) to be a codification and extension of the broad turnover power available under Chapters X and XII of the Bankruptcy Act can be found in the policies of the Bankruptcy Code.

Reconstruction Finance Corp. v. Kaplan, 185 F.2d 791, *supra*, was the leading case in a line of cases holding that, in reorganization proceedings under the Bankruptcy Act,[57] the bankruptcy court had the power to order turnover of assets of the debtor which had been lawfully repossessed by a secured creditor after default, where those assets were necessary for a successful reorganization.[58] In that case, after a Chapter X

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[57]"Reorganization" under the Bankruptcy Act, of course, was limited to Chapter X; Chapters XI and XII providing for more limited "arrangement" proceedings. The denomination of proceedings under Chapter 11 of the Bankruptcy Code as "reorganizations" is a meaningful choice of term.

[58]See, e.g., *Grand Boulevard Inv. Co. v. Strauss*, 78 F.2d 180 (8th Cir. 1935) [turnover of property in possession of mortgagee in §77B proceeding]; *In re Prudence-Bonds Corp.*, 77 F.2d 328 (2d Cir.), *cert. denied*, 296 F.2d 584 (1935) [turnover of rents and profits by mortgagee in §77B proceeding]; *John Hancock Mut. Life Ins. Co. v. Casey*, 134 F.2d 162 (1st Cir.) (per

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petition had been filed and a plan approved, the district court authorized the trustees to operate the business and directed the pledgee to deliver to the trustees all the property of the debtor in its possession. *Id.* at 793-794. The First Circuit affirmed the turnover order, finding the power to order turnover implicit in the broad grant of jurisdiction in §111 of the Bankruptcy Act over "the debtor and its property, wherever located" and the rehabilitative purpose of Chapter X.[59] *Id.* at 794-795.

The policy considerations which led the court in *Reconstruction Finance Corp. v. Kaplan* to take an expansive view of the jurisdiction of the reorganization court over property in the possession of secured creditors are equally applicable to Chapter 11 reorganization proceedings under the Bankruptcy Code. As the following passage from the House Committee Report illustrates, the goal of reorganization under the Bankruptcy Code remains the rehabilitation of business debtors, so as to preserve the going concern value of the business:

> The purpose of a business reorganization case, unlike a liquidation case, is to restructure a business's finances so that it may continue to operate, provide its employees with jobs, pay its creditors, and produce a return for its stockholders. The premise of a business reorganization

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curiam), *cert. denied*, 319 U.S. 757 (1943) [turnover of mortgaged premises and collected rents from mortgagee in Chapter X proceeding]; *In re. Franklin Garden Apartments, Inc.*, 124 F.2d 451 (2d Cir. 1941) [turnover of mortgaged premises and collected rents in Chapter X proceeding]; *In re Third Ave. Transit Co.*, 198 F.2d 703, 706 (2d Cir. 1952) [court acknowledged power to order turnover of cash from mortgage indenture trustee].

[59]The First Circuit also found support for a broad turnover power implicit in §257 of the Bankruptcy Act, which granted the bankruptcy trustee a right to possession of property held by mortgagees or trustees under a trust deed, but the decision of property held by mortgagees or trustees under a trust deed, but the decision did not rest on that ground. *Id.* at 795.

> is that assets that are used for production in the industry for which they were designed are more valuable than those same assets sold for scrap. Often, the return on assets that a business can produce is inadequate to compensate those who have invested in the business. Cash flow problems may develop, and require creditors of the business, both trade creditors and long-term lenders, to wait for payment of their claims. If the business can extend or reduce its debts, it often can be returned to a viable state. It is more economically efficient to reorganize than to liquidate, because it preserves jobs and assets.

H.R. Rep. No. 95-595, *supra*, at 220. Attainment of this rehabilitative goal is obviously dependent to a great extent on the ability of the trustee or debtor-in-possession to collect, retain and use the assets of the debtor in the operation of the business. See, 6 *Collier on Bankruptcy* ¶3.05, at 431 (14th ed. 1977). A broad turnover power capable of retrieving assets in the possession of secured creditors is thus as vital to successful reorganization under the Code as it was under Chapter X of the Bankruptcy Act.

In contrast, the narrow view of the turnover power advocated by the government conflicts with the rehabilitative purposes of the reorganization chapter[60] by permitting either the IRS or secured creditors, by precipitous action, to deny the trustee the use of the debtor's assets without regard to the extent of the debtor's equity in those assets. The drastic impact of such a rule on the prospects for successful rehabilitation of the debtor cannot be reconciled with the comments in floor debates by the House Sponsor of H.R. 8200 indicating that Congress intended to *encourage* reorganizations by in-

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[60]Sections 542(a), 541 and 363 of the Bankruptcy Code are, of course, general provisions applicable in liquidating bankruptcies and Chapter 13 proceedings as well as reorganizations. A similar conflict may exist in liquidation cases with a congressional policy favoring the use of assets in the winding up operation of the business, see generally 11 U.S.C. (Supp. IV) §§721; 363(c), but that need not be decided here.

corporating the *combined* reorganization powers available under Chapters X, XI and XII of the Bankruptcy Act into a single consolidated reorganization chapter under the Code.[61] Furthermore, the narrow view of the turnover authority espoused by the government is inconsistent with the expanded jurisdiction of the bankruptcy court under the Bankruptcy Code. Like §111 of Chapter X of the Bankruptcy Act, 28 U.S.C. §1471(e) vests the bankruptcy court with pervasive jurisdiction over all the property of the debtor wherever located. Given this broad jurisdictional grant, the inherent

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[61] During the House debate on the Compromise bill, Representative Edwards, a House sponsor and compromise manager, stated that:

> "The amendment also encourages business reorganizations by a streamlined new commerical reorganization chapter . . . . It will protect the investing public, protect jobs, and help save troubled business".

124 Cong. Rec. 32392 (1978).

In debates prior to the initial passage of H.R. 8200, Representative Edwards explained the reasons for consolidation of the three reorganization chapters of the Bankruptcy Act of 1898 into a single Chapter 11 under the Bankruptcy Code:

> "Now for businesses, we make it easier for them to repay their creditors, too . . . [N]one of the three chapters offers the full scope of bankruptcy powers that a business could use to reorganize and repay its creditors rather than going into straight bankruptcy, under which creditors usually get very little. . .
> We consolidate the three reorganization chapters into one flexible chapter. *It gives the debtors the combined powers of the three current chapters, and gives creditors the combined protection of the three chapters.* . . .
> This way creditors get more than if the business went into straight liquidation.
> It also will save more businesses, which will protect jobs and protect public and private investors."

123 Cong. Rec. 35446 (1977) [emphasis added].

During these same debates, Representative Rodino, Chairman of the House Judiciary Committee, observed that "[f]or businesses, the bill facilitates reorganizations, protecting investments, and jobs".
123 Cong. Rec. 35444 (1977).

power of a court of equity to protect its jurisdiction, see, *Continental Ill. Nat'l. Bank & Trust Co. v. Chicago, Rock Island & Pac. Ry.*, 294 U.S. 648, 675 (1935), the power granted by 11 U.S.C. (Supp. IV) §105 to make orders necessary to enforce the provisions of the Bankruptcy Code, and the power supplied by the "All Writs Statute" to issue writs in aid of its jurisdiction, see, 28 U.S.C. §1651(a), it is doubtful that the bankruptcy court would lack the power to order turnover of property in the possession of the IRS after a tax levy if the debtor retained an interest in that property.[62] This is especially so since the Government's reading of §§542(a), 541(a)(1) and 363 would in effect have jurisdiction turn on possession, while the House Committee report unequivocally declares that possession of the *res* is no longer relevant to jurisdiction under the Code, H.R. Rep. No. 95-595, *supra*, at 48-49.

Despite this expanded jurisdiction, if the government is correct in its rigid construction of the phrase "property of the estate", then under the Code, a bankruptcy court confronted with the facts of *Reconstruction Finance v. Kaplan* would be powerless to order turnover of the inventory.[63] The inevitable result could be the liquidation of a *solvent* debtor and con-

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[62]Bankruptcy Judge Hayes ruled that the IRS was subject to the automatic stay provision, 11 U.S.C. (Supp. IV) §362(a). Pet. App. at 34a-35a. The IRS never appealed from that aspect of the decision. Pet. App. at 50a, n.7; *United States v. Whiting Pools, Inc.*, 674 F.2d 144, 146, *supra;* Pet. App. at 3a. To that extent, the IRS has conceded that the bankruptcy court had jurisdiction over the assets in question.

[63]Arguably, the government's construction of "property of the estate" would also serve to overrule cases in which the secured creditor was denied reclamation of collateral from the debtor and the trustee or debtor-in-possession was authorized to use the collateral. See, e.g., *In re Bermec Corp.*, 445 F.2d 367 (2d Cir. 1971); *In re Yale Express Sys., Inc.* 370 F.2d 433 (2d Cir. 1966), *on remand*, 384 F.2d 990 (2d Cir. 1967). If the right to possession as of the commencement of the case is determinative of the right to use, sell or lease "property of the estate", then the secured creditor should be entitled to reclamation in any case in which there was a default pre-petition.

siderable economic loss, all to the detriment of the unsecured creditors, stockholders and employees of the debtor. Such a result is in irreconcilable conflict with the congressional policy favoring rehabilitation of business debtors, and could not have been intended by Congress.[64]

G. *Whiting is Entitled to the Turnover and Use of the Seized Property Under Section 542(a) if the United States can be Given Adequate Protection.*

The balancing of the respective interests of the debtor and the government in the seized property should not go to the issue of what percentage or which attributes of each item of property are "property of the estate". Rather, it should go to the issue of whether the debtor can use the property notwithstanding the substantial interest of the United States in the property. The debtor's right to use the property is determined by Bankruptcy Code §363. It is not determined by the Internal Revenue Code. The debtor's ability to use the property versus the United States' rights to sell the property concerns a dispute over remedies not over substantive or ownership rights. Accordingly, as the automatic stay provisions of §362(a) prevent an exercise of remedies by the United States and §363 grants the debtor the remedy of use of its property under certain circumstances, the question is which remedy should the Court provide, and to whom. Where, as here, the retention and sale of the

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[64] It must be presumed that Congress was aware of *Reconstruction Finance Corp. v. Kaplan* as a judicial construction of existing law. See, *Director, Office of Workers' Compensation Programs v. Perini North River Assoc.*, ___ U.S. ___ 103 S.Ct. 634, 649 (1983); *Cannon v. University of Chicago*, 441 U.S. 677, 696-697 (1979). In fact, when the drafters of the House and Senate Committee Reports gave an example of a circumstance in which authorization to operate a business should be granted in a liquidation case under 11 U.S.C. (Supp. IV) §721, the example chosen was "the operation of a watch company to convert watch movements and cases into completed watches which will bring much higher prices," a fact pattern taken from *Reconstruction Finance Corp. v. Kaplan*. H.R. Rep. No. 95-595, *supra*, at 380, S. Rep. No. 95-989, *supra*, at 94.

seized property by the Internal Revenue Service will put the debtor out of business and prevent any rehabilitation, it is appropriate for the Bankruptcy Court to use its equitable powers to fashion the remedy of "adequate protection"[65] for the United States while giving the debtor the remedy of the use of its property. This was exactly the course decided upon by the bankruptcy court below. (Pet. App. at 43a).

Although "adequate protection" is not a defined term under the Bankruptcy Code, examples are given in §361, including periodic cash payments to the affected creditor[66] and additional or replacement liens.[67] According to the legislative history of §361,[68] the concept derives from the Fifth Amendment protection of property interests and earlier decisions of this court[69] and, as the legislative history makes clear, the bankruptcy court is expected to utilize general equitable considerations to arrive at an appropriate judicial result on the facts of each case.[70]

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[65] §363(e) provides, in part, that . . . . "at any time, on request of an entity that has an interest in property used, sold, or leased, or proposed to be used, sold, or leased, by the trustee, the court shall prohibit or condition such use, sale, or lease as is necessary to provide adequate protection of such interest."

[66] §361(1).

[67] §361(2).

[68] House Report No. 95-595, 95th Cong., 1st Sess. 338-40 (1977); Senate Report No. 95-989, 95th Cong., 2nd Sess. 49, 53-54 (1978).

[69] *Wright v. Union Central Life Ins. Co.*, 311 U.S. 273, *supra*, and *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555 (1935).

[70] See, e.g., House Report, *supra*, note 68, where it was stated:

> "It is expected that the courts will apply the concept in light of facts of each case and general equitable principles. It is not intended that the courts will develop a hard and fast rule that will apply in

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In the light, then, of the statutory provisions and the applicable legislative history, it is respectfully submitted that the better reasoned cases that have considered the issues involved in this lawsuit have focused their attention on whether or not the interests of the United States can be adequately protected if the seized property is turned over to the debtor-in-possession.[71] If the government's interests can be adequately protected, and unless the property is of "inconsequential value or benefit to the estate" (§542(a)), these cases would mandate a turnover to the debtor-in-possession. Such a determination is not automatic, however, for although the court in *Aurora* made such findings and ordered a turnover by the Internal Revenue Service, the court in *Hudson Valley* found a lack of adequate protection and denied turnover solely on that ground, and the courts in both *Alpa* and *Bristol* ordered further hearings on the issue of adequate protection.

In the present case, the bankruptcy court found not only that possession of the seized property was essential to Whiting's ability to function as a debtor-in-possession, but that, if turnover were directed, the interests of the government could be adequately protected. Accordingly the court structured specific conditions in its order so as to assure that the government's interests in the property would be adequately protected.[72]

—*Footnote continued from preceding page*

every case. The time and method of valuation is not specified precisely, in order to avoid that result. There are an infinite number of variations possible in dealings between debtors and creditors, the law is continually developing, and new ideas are continually being implemented in this field. The flexibility is important to permit the courts to adapt to varying circumstances and changing modes of financing."

[71]See, e.g. *In the Matter of Aurora Cord & Cable Company, Inc.*, 2 B.R. 342, *supra; Alpa Corporation v. IRS*, 7 B.C.D. 791, *supra; Bristol Convalescent Home, Inc. v. IRS*, 7 B.C.D. 1151, *supra; In re Hudson Valley Ambulance Service, Inc.*, 11 B.R. 860, *supra*.

[72]Pet. App. at 43a

The interpretation of the Bankruptcy Code sought by the government in this case, in effect, would eliminate the power of the bankruptcy court to perform the judicial function of determining and providing adequate protection as the counterbalance to turnover under §542(a). We believe that the concept of adequate protection was carefully inserted into the bankruptcy code in order to give the bankruptcy court needed flexibility to balance the interests of all parties involved in a reorganization case, thereby enabling the court to structure mechanisms to protect the pre-petition interests of creditors or lienors in the debtor's assets while permitting the debtor, as debtor-in-possession, to use those assets in its rehabilitation efforts. We believe that the counterbalance of adequate protection and turnover can work under appropriate judicial scrutiny, and that the bankruptcy court order of turnover, under the facts in this case, was consistent with the purpose and intent of the Bankruptcy Code.

CONCLUSION

For the reasons stated above, the order and decision of the court of appeals should be affirmed.

Respectfully submitted,

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APPENDIX A

STATUTES

Bankruptcy Code, 11 U.S.C. (Supp. IV):

§105 *Power of court*

(a) The bankruptcy court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title.

§106. *Waiver of sovereign immunity*

(a) A governmental unit is deemed to have waived sovereign immunity with respect to any claim against such governmental unit that is property of the estate and that arose out of the same transaction or occurrence out of which such governmental unit's claim arose.

(b) There shall be offset against an allowed claim or interest of a governmental unit any claim against such governmental unit that is property of the estate.

(c) Except as provided in subsections (a) and (b) of this section and notwithstanding any assertion of sovereign immunity —

(1) a provision of this title that contains "entity", or "governmental unit" applies to governmental units; and

(2) a determination by the court of an issue arising under such a provision binds governmental units.

§361. *Adequate protection*

When adequate protection is required under section 362, 363, or 364 of this title of an interest of an entity in-property, such adequate protection may be provided by —

(1) requiring the trustee to make periodic cash payments to such entity, to the extent that the stay under

section 362 of this title, use, sale, or lease under section 363 of this title, or any grant of a lien under section 364 of this title results in a decrease in the value of such entity's interest in such property;

(2) providing to such entity an additional or replacement lien to the extent that such stay, use, sale, lease, or grant results in a decrease in the value of such entity's interest in such property; or

(3) granting such other relief, other than entitling such entity to compensation allowable under section 503 (b)(1) of this title as an administrative expense, as will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property.

§363. *Use, sale, or lease of property*

(a) In this section, "cash collateral" means cash, negotiable instruments, documents of title, securities, deposit accounts, or other cash equivalents in which the estate and an entity other than the estate have an interest.

(b) The trustee, after notice and a hearing, may use, sell or lease, other than in the ordinary course of business, property of the estate.

(c)(1) If the business of the debtor is authorized to be operated under section 721, 1108, or 1304 of this title and unless the court orders otherwise, the trustee may enter into transactions, including the sale or lease of property of the estate, in the ordinary course of business, without notice or a hearing, and may use property of the estate in the ordinary course of business without notice or a hearing.

(2) The trustee may not use, sell or lease cash collateral under paragraph (1) of this subsection unless —

(A) each entity that has an interest in such cash collateral consents; or

(B) the court, after notice and a hearing, authorizes such use, sale, or lease in accordance with the provisions of this section.

§543. *Turnover of property by a custodian . . .*

(b) A custodian shall —

(1) deliver to the trustee any property of the debtor transferred to such custodian, or proceeds of such property, that is in such custodian's possession, custody, or control on the date that such custodian acquires knowledge of the commencement of the case;

Internal Revenue Code, 26 U.S.C.:

§6332. *Surrender of property subject to levy*

(a) Requirement. Except as otherwise provided in subsection (b), any person in possession of (or obligated with respect to) property or rights to property subject to levy upon which a levy has been made shall, upon demand of the Secretary, surrender such property or rights (or discharge such obligation) to the Secretary, except such part of the property or rights as is, at the time of such demand, subject to an attachment or execution under any judicial process.

§6335. *Sale of seized property*

(a) Notice of seizure. As soon as practicable after seizure or property, notice in writing shall be given by the Secretary to the owner of the property (or, in the case of personal property, the possessor thereof), or shall be left at his usual place of

abode or business if he has such within the internal revenue district where the seizure is made. If the owner cannot be readily located, or has no dwelling or place of business within such district, the notice may be mailed to his last known address. Such notice shall specify the sum demanded and shall contain, in the case of personal property, an account of the property seized and, in the case of real property, a description with reasonable certainty of the property seized.

(b) Notice of sale. The Secretary shall as soon as practicable after the seizure of the property give notice to the owner, in the manner prescribed in subsection (a), and shall cause a notification to be published in some newspaper published or generally circulated within the county wherein such seizure is made, or, if there be no newspaper published or generally circulated in such county, shall post such notice at the post office nearest the place where the seizure is made, and in not less than two other public places. Such notice shall specify the property to be sold, and the time, place, manner, and conditions of the sale thereof. Whenever levy is made without regard to the 10-day period provided in section 6331(a), public notice of sale of the property seized shall not be made within such 10-day period unless section 6336 (relating to sale of perishable goods) is applicable.

(c) Sale of indivisible property. If any property liable to levy is not divisible, so as to enable the Secretary by sale of a part thereof to raise the whole amount of the tax and expenses, the whole of such property shall be sold.

(d) Time and place of sale. The time of sale shall not be less than 10 days nor more than 40 days from the time of giving public notice under subsection (b). The place of sale shall be within the county in which the property is seized, except by special order of the Secretary.

(e) *Manner and conditions of sale.*

(1) *Minimum price.* Before the sale the Secretary shall determine a minimum price for which the property shall be sold, and if no person offers for such property at the sale the amount of the minimum price, the property shall be declared to be purchased at such price for the United States; otherwise the property shall be declared to be sold to the highest bidder. In determining the minimum price, the Secretary shall take into account the expense of making the levy and sale.

(2) *Additional rules applicable to sale.* The Secretary shall by regulations prescribe the manner and other conditions of the sale of property seized by levy. If one or more alternative methods or conditions are permitted by regulations, the Secretary shall select the alternatives applicable to the sale. Such regulations shall provide:

(A) That the sale shall not be conducted in any manner other than —

(i) by public auction, or

(ii) by public sale under sealed bids.

(B) In the case of the seizure of several items of property, whether such items shall be offered separately, in groups, or in the aggregate; and whether such property shall be offered both separately (or in groups) and in the aggregate, and sold under whichever method produces the highest aggregate amount.

(C) Whether the announcement of the minimum price determined by the Secretary may be delayed until the receipt of the highest bid.

(D) Whether payment in full shall be required at the time of acceptance of a bid, or whether a part of such payment may be deferred for such period (not to exceed

1 month) as may be determined by the Secretary to be appropriate.

§6337. *Redemption of property*

(a) Before sale. Any person whose property has been levied upon shall have the right to pay the amount due, together with the expenses of the proceeding, if any, to the Secretary at any time prior to the sale thereof, and upon such payment the Secretary shall restore such property to him, and all further proceedings in connection with the levy on such property shall cease from the time of such payment.

(b) Redemption of real estate after sale.

(1) *Period.* The owners of any real property sold as provided in section 6335, their heirs, executors, or administrators, or any person having any interest therein, or a lien thereon, or any person in their behalf, shall be permitted to redeem the property sold, or any particular tract of such property, at any time within 120 days after the sale thereof.

§6338. *Certificate of sale; deed of real property*

(a) Certificate of sale. In the case of property sold as provided in section 6335, the Secretary shall give to the purchaser a certificate of sale upon payment in full of the purchase price. In the case of real property, such certificate shall set forth the real property purchased, for whose taxes the same was sold, the name of the purchaser, and the price paid therefor.

(b) Deed to real property. In the case of any real property sold as provided in section 6335 and not redeemed in the manner and within the time provided in section 6337, the Secretary shall execute (in accordance with the laws of

the State in which such real property is situated pertaining to sales of real property under execution) to the purchaser of such real property at such sale, upon his surrender of the certificate of sale, a deed of the real property so purchased by him, reciting the facts set forth in the certificate.

(c) Real property purchased by United States. If real property is declared purchased by the United States at a sale pursuant to section 6335, the Secretary shall at the proper time execute a deed therefor, and without delay cause such deed to be duly recorded in the proper registry of deeds.

§6339. *Legal effect of certificate of sale of personal property and deed of real property.*

(a) Certificate of sale of property other than real property. In all cases of sale pursuant to section 6335 of property (other than real property), the certificate of such sale —

(1) *As evidence.* Shall be prima facie evidence of the right of the officer to make such sale and conclusive evidence of the regularity of his proceedings in making the sale; and

(2) *As conveyances.* Shall transfer to the purchaser all right, title, and interest of the party delinquent in and to the property sold; and . . .

(b) Deed of real property. In the case of the sale of real property pursuant to section 6335 —

(1) *Deed as evidence.* The deed of sale given pursuant to section 6338 shall be prima facie evidence of the facts therein stated; and

(2) *Deed as conveyance of title.* If the proceedings of the Secretary as set forth have been substantially in

accordance with the provisions of law, such deed shall be considered and operate as a conveyance of all the right, title, and interest the party delinquent had in and to the real property thus sold at the time the lien of the United States attached thereto.

§6342. *Application of proceeds of levy . . .*

(b) Surplus proceeds. Any surplus proceeds remaining after the application of subsection (a) shall, upon application and satisfactory proof in support thereof, be credited or refunded by the Secretary to the person or persons legally entitled thereto.

28 U.S.C. §1471(e):

(e) The bankruptcy court in which a case under title 11 is commenced shall have exclusive jurisdiction of all of the property, wherever located, of the debtor, as of the commencement of such case.

All Writs Statute, 28 U.S.C. §1651(a):

§1651. *Writs*

(a) The Supreme Court and all courts established by Act of Congress may issue all writs necessary or appropriate in aid of their respective jurisdictions and agreeable to the usages and principles of law.

Office-Supreme Court, U.S.
FILED
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ALEXANDER L. STEVAS,
CLERK

No. 82-215

In the Supreme Court of the United States

OCTOBER TERM, 1982

UNITED STATES OF AMERICA, PETITIONER

v.

WHITING POOLS, INC.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF FOR THE UNITED STATES

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In the Supreme Court of the United States

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REPLY BRIEF FOR THE UNITED STATES

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1. Simply put, our position in this case is that nothing in the language of the new Bankruptcy Code or its legislative history supports the proposition that Congress intended to alter the prior settled rule that property seized by levy to satisfy a debtor's delinquent federal tax liabilities *prior* to the filing of the bankruptcy petition is not to be included in the bankruptcy estate. Indeed, the plain language and the legislative history support the opposite conclusion.[1] Hence,

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[1]As we explained in detail in our opening brief (at 13-15), Section 542(a) requires an entity to turn over property that the trustee may use, sell or lease under Section 363. In turn, Section 363(b) and (c) specify that the trustee may use, sell or lease "property of the estate." As the legislative history indicates, Section 541 defines "property of the estate." H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 367 (1977); S. Rep. No. 95-989, 95th Cong., 2d Sess. 82 (1978). Accordingly, Section 542(a)

we submit that a bankruptcy court in a reorganization proceeding under Chapter 11 of the new Bankruptcy Code may not compel the government, pursuant to 11 U.S.C. (Supp. IV) 542(a), to turn over to the debtor-in-possession property which the government seized by levy to satisfy the debtor's tax liabilities prior to the filing of the bankruptcy petition.

In response, respondent counters (Br. 4, 12-15, 42-43) that if the judgment below is reversed in accordance with our submission, then Section 542(a) of the Bankruptcy Code could never be invoked by a trustee to obtain repossessed collateral in the hands of a secured creditor. That, however, is not the necessary consequence of a decision in favor of the government here. The only question presented for decision in this case is whether the tax collector must turn over property seized by a pre-bankruptcy tax levy. And contrary to respondent's contention, that issue is not inextricably tied to the resolution of the further question respondent seeks to raise as to whether other creditors must surrender repossessed collateral.

As we pointed out in our opening brief (at 8-9), the court of appeals' analysis proceeded upon a three-step syllogism. First, the court noted that under Chapters X and and XII of the prior bankruptcy law, a bankruptcy court could order secured creditors to turn over repossessed property to the reorganizing debtor. Although the court of appeals acknowledged that Congress did not enact specific provisions in the new Bankruptcy Code that were comparable to the prior

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requires an entity to turn over the debtor's legal and equitable interests in property as of the date the petition is filed. As we further pointed out, the debtor's interests in property that has been seized by a tax levy are limited to a right to redeem, a right to surplus proceeds of sale, if any, and a right to receive notice of sale. Those are the sole interests that passed to the debtor's estate and, thus, the trustee had no right to use, sell or lease the seized property.

law, it believed that Congess could not have intended to discontinue that authority (see Pet. App. 13a-17a). The second step in the court's reasoning was to analogize the government's position after a tax levy to that of a secured creditor who had repossessed the debtor's property. Finally, the court concluded that the debtor is as entitled to turnover of property seized to satisfy delinquent taxes as it is to turnover of collateral in the possession of a secured creditor.

But even assuming arguendo that the court of appeals correctly inferred that Congress intended to incorporate in the new Bankruptcy Code a turnover rule with respect to secured creditors despite its failure to employ language that explicitly requires that result, it does not automatically follow that Congress also intended to require the government to surrender property seized prior to bankruptcy to satisfy delinquent taxes. As we pointed out in detail in our opening brief (at 29-39), in enacting the new Bankruptcy Code, Congress was sensitive to the impact of the bankruptcy laws upon the functioning of the tax collection system and paid careful attention to the changes in bankruptcy laws that affected the collection of taxes. Nevertheless, the legislative history does not even suggest, much less state, that Congress intended to alter the prior law governing the effect of pre-bankruptcy tax levies. Under that prior law, it was clear that the government was not required to surrender to the trustee for inclusion in the bankruptcy estate property seized prior to bankruptcy to satisfy delinquent taxes. See *Phelps* v. *United States*, 421 U.S. 330 (1975); *In re Pittsburgh Penguins Partners*, 598 F.2d 1299 (3d Cir. 1979). In these circumstances, there is no basis for assuming that Congress made a drastic change in the law with respect to

pre-bankruptcy tax levies, without any mention of its intent to do so.[2]

Furthermore, in treating the cases of the secured creditor and the government's seizure of property by tax levy as though they were inseparable, respondent ignores the basis of the holding below. The court of appeals did not extract the substantive rule that secured creditors must surrender repossessed collateral from the express terms of the relevant statutes. Indeed, the statutory language could not be read to support that result. Rather, it reasoned that because a

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[2]In respondent's view (Br. 24-28), Section 541 is a self-executing provision that automatically brings within the bankruptcy estate the property it enumerates, while Section 542(a) requires an entity to turn over a separate class of property that is defined by Section 363. However, the legislative history of Section 541 makes it clear that "[t]his section defines property of the estate, and specifies what property becomes property of the estate." H.R. Rep. No. 95-595, *supra*, at 367; S. Rep. No. 95-989, *supra*, at 82. The legislative history of Section 363, on the other hand, does not suggest that Congress intended to define a separate category or class of property that is to be included in the bankruptcy estate. To the contrary, the terms of Section 363 indicate that the trustee may use, sell or lease "property of the estate," if the other requirements of the Section are met. 11 U.S.C. (Supp. IV) 363(b) and (c). Moreover, as relevant here, Section 542(a) directs that an entity must relinquish to the trustee property "that the trustee may use, sell, or lease under section 363 of this title." Thus, an entity must turn over pursuant to Section 542(a) only "property of the estate" that the trustee is entitled to use, sell or lease under Section 363.

Finally, respondent also suggests (Br. 10, 25-26) that Congress intended items of property in which the debtor has an interest to be included in the estate, rather than including only the debtor's interests in property, and that the test whether property is to be included in the estate should be whether the debtor has a "substantial" interest in it. The comments of the principal congressional sponsors made just prior to enactment of the Bankruptcy Code are precisely to the contrary. Section 541 is an "all embracing definition" which includes all "beneficial rights and interests" that the debtor may have, but "*only the debtor's interests* in such property becomes property of the estate." See, *e.g.*, 124 Cong. Rec. 32399, 33999 (1978) (emphasis supplied). See also S. Rep. No. 95-989, *supra*, at 92; H.R. Rep. No. 95-595, *supra* at 367-369.

trustee's ability to obtain repossessed collateral for inclusion in the bankruptcy estate was such an important tool of reorganization under Chapter X of prior law (*Reconstruction Finance Corp.* v. *Kaplan*, 185 F.2d 791 (1st Cir. 1950)), Congress could not have intentionally omitted it in the new Bankruptcy Code (see Pet. App. 13a-15a). It supported its view that Congress intended to require secured creditors to surrender repossessed collateral by the statements of witnesses who urged Congress to incorporate that rule in the Bankruptcy Code.

But the plain fact of the matter is that Congress did not enact the witnesses' proposals. Nevertheless, despite Congress' rejection of the National Bankruptcy Conference's proposal to make a turnover rule explicit with respect to secured creditors,[3] the court of appeals believed that the

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[3]As we indicated in our opening brief (at 43-44), Congress rejected the National Bankruptcy Conference's proposal. Under that proposal, Section 543, which requires a custodian to turn over property of the debtor that came into the custodian's possession prior to bankruptcy, would have been amended to require a creditor to turn over property of the debtor in the creditor's possession when the bankruptcy case was commenced. See Pet. App. 21a n.16.

Section 543, as enacted, is similar in scope to Sections 257 and 507 of prior law (Act of June 22, 1938, ch. 575, 52 Stat. 902 and 927, 11 U.S.C. 657 and 907). As we indicated in detail in our opening brief (at 29-30), Sections 257 and 507 explicitly required a "trustee under a trust deed or a mortgagee under a mortgage" to relinquish to the trustee property in their possession. Section 543 requires a "custodian" to surrender property to the trustee and the term custodian is defined by Section 101(10) as a—

> (A) receiver or trustee of any property of the debtor, appointed in a case or proceeding not under this title;
>
> (B) assignee under a general assignment for the benefit of the debtor's creditor's; or
>
> (C) trustee, receiver, or agent under applicable law, or under a contract, that is appointed or authorized to take charge of property of the debtor for the purpose of enforcing a lien against such property, or for the purpose of general administration of such property for the benefit of the debtor's creditors * * *.

subsequent addition of Section 542(a) was intended to satisfy the witnesses' requests. While it is questionable to infer that Congress endorsed the witnesses' views with respect to repossessed collateral, it is wholly unwarranted to conclude that Congress also intended to extend the rule with respect to repossessed collateral to the discrete context of federal tax levies. Plainly, obtaining property seized by a pre-bankruptcy tax levy was not an important tool of reorganization proceedings under prior law. Indeed, such property was not included in bankruptcy estates. Furthermore, none of the statements relied upon by the court below or cited by respondent (Br. 32-34) indicate that the witnesses believed it necessary or appropriate to change the law in this regard. And neither the court of appeals, nor respondent, has cited any pertinent legislative history reflecting Congress' intent to change the law with regard to pre-bankruptcy tax levies. There is accordingly no reliable basis for the assumption made by the court below that Congress intended to include property seized by a pre-bankruptcy tax levy within the compass of any prior rule that may continue to exist for collateral repossessed by private creditors.[4]

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[4]Respondent urges (Br. 43-46) that in ordering the government to turn over the seized property to the trustee, the bankruptcy court provided adequate protection for the government's interests by conditioning the delivery of the property upon respondent's payment to the government of $20,000 (see Pet. App. 39a-43a). But as we explained in detail in our opening brief (at 4 n.1), this payment included $15,000 from a bank account that was itself the subject of a pre-petition tax levy. See also Pet. App. 31a & n.21. Hence, to a large extent, the "adequate protection" which respondent is willing to confer on the government involves simply putting up the government's own property as security to insure that respondent will not dissipate other property seized by the government for back taxes.

At all events, the issue of adequate protection is not before the Court for even the court of appeals refrained from adopting respondent's argument on this point. In reversing the district court (which had

CONCLUSION

For the reasons stated above, and in our opening brief, the judgment of the court of appeals should be reversed.

Respectfully submitted.

REX E. LEE
Solicitor General

APRIL 1983

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reversed the bankruptcy court's turnover order), the court of appeals remanded the case with instructions to the bankruptcy court to address and redetermine the issue of the adequacy of the protection before any new turnover order is issued (Pet. App. 2a, 31a-32a).

DOJ-1983-04

No. 82-215-CFX
Status: GRANTED

Title: United States, Petitioner
v.
Whiting Pools, Inc.

Docketed:
August 6, 1982

Court: United States Court of Appeals
for the Second Circuit

Counsel for petitioner: Solicitor General

Counsel for respondent: Relin, Lloyd H.

Entry	Date	Note	Proceedings and Orders
1	May 26 1982		Application for extension of time to file petition and order granting same until July 6, 1982 (Marshall, May 28, 1982).
2	Jun 24 1982		Application for further extension of time to file petition and order granting same until August 6, 1982 (Marshall, June 28, 1982).
3	Aug 6 1982	G	Petition for writ of certiorari filed.
4	Sep 15 1982		DISTRIBUTED. October 8, 1982
5	Sep 30 1982	F	Response requested.
6	Oct 29 1982		Brief of respondent Whiting Pools, INc. in opposition filed.
7	Nov 3 1982		DISTRIBUTED. November 24, 1982
8	Nov 29 1982		Petition GRANTED.
			**********
9	Dec 15 1982	G	Motion of the parties to dispense with printing the joint appendix filed.
10	Dec 28 1982		DISTRIBUTED. Jan. 7, 1983. (Motion to dispense with printing joint appendix).
11	Jan 10 1983		Motion of the parties to dispense with printing the joint appendix GRANTED.
13	Jan 11 1983		Order extending time to file brief of petitioner on the merits until January 31, 1983.
14	Jan 27 1983		Record filed.
15	Jan 27 1983		Certified original record and C.A. proceedings received.
16	Jan 31 1983		Brief of petitioner United States filed.
18	Mar 1 1983		Order extending time to file brief of respondent on the merits until March 14, 1983.
19	Mar 14 1983		Brief of respondent Whiting Pools, INc. filed.
20	Mar 24 1983		SET FOR ARGUMENT. Tuesday, April 19, 1983. (3rd case) 1 hour
21	Mar 24 1983		CIRCULATED.
22	Apr 12 1983	X	Reply brief of petitioner filed.
23	Apr 19 1983		ARGUED.